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 28 November 2017

1. Overview

1.1 The key discussions at the Financial Markets Liaison Group (FMLG) meeting were based on the topics listed below:

1.1.1 A presentation by the JSE Limited (JSE) and Share Trading Transactions Totally Electronic (Strate) following incidents that resulted in settlement challenges in September 2017.

1.1.2 A joint presentation by the Treasurers of the four major banks on key market liquidity risks that South Africa could face during December 2017.

1.1.3 Feedback from the Financial Markets Review Committee (FMRC).

1.1.4 The progress reports from the subcommittees and working groups of the FMLG, as tabled by the respective chairpersons.

2. Summary of discussions

2.1 Settlement challenges encountered in September 2017

2.1.1 The following incidents occurred at the JSE and Strate:

a. The adjustment of positions for a large corporate action was not completed on the due date, leading to a delay in the opening of the equity derivatives market on 20 September 2017.

b. On 21 September 2017, the futures closeout was not reflected in the equity market trading system, which required that the system be rebooted. As a consequence, the equity market open and futures closeout were delayed by two hours.

c. On 21 September 2017, an incorrect valuation of one equity derivatives basket and related expiries resulted in incorrect margin calls.

d. The JSE Equities Clearing System failed to recognise 25 September 2017 as a public holiday for certain transactions.

e. Challenges were experienced with the implementation of Strate's new settlement system, called Debt Instrument Solutions (DIS), from 26 September to 3 October 2017.

2.1.2 The causes of the five incidents were identified and analysed, and some remedial actions had already been implemented. An independent consultant was appointed to investigate the source of these challenges and make appropriate recommendations.

2.1.3 It was agreed that better communication with market participants with regard to new projects as well as better change management would help improve the implementation process.

2.2 Possible financial market liquidity risks that South Africa could face during December 2017

2.2.1 The purpose of the presentation by the Treasurers of the four major commercial banks was to highlight the key risks faced by the South African financial markets during December 2017. The presentation highlighted, among other things, the following risks:

a. There is a possibility of significant portfolio outflows, mostly from passive investors, if ratings agency Moody's downgrades South Africa's local currency debt to sub-investment grade. While the local market demonstrated capacity to handle huge outflows over a month or 90-day period, in this risk scenario, however, the challenge is that the outflows could possibly take place within a much shorter space of time than observed before. Financial asset price movements could also be exacerbated by seasonal low liquidity experienced in December.

b. The South African Reserve Bank (SARB) concurred with the possible risks identified and indicated that it annually prepares for seasonal liquidity pressures that often manifest in December, based on possible risks identified. The SARB expressed confidence that its operational toolkit should be able to deal with any volatility, and contribute to the smooth functioning of financial markets.

2.3 Feedback from the Financial Markets Review Committee

2.3.1 The SARB, Financial Services Board (FSB) and National Treasury (NT) established the Financial Markets Review Committee (FMRC) to propose recommendations to reinforce conduct standards in the wholesale financial markets.

2.3.2 The FMRC held two meetings, from which it formed committees that had been tasked with work.

2.3.3 The FMRC conducted a market survey and was studying the responses. The FMRC is expected to publish the discussion paper for public comment towards the end of July 2018. The final paper incorporating public comments will be published towards the end of 2018. The draft review will also seek comments on projects such as the aligning of the authorised dealer licensing with over-the-counter (OTC) derivative provider (ODP) requirements, and the further development of the repurchase (repo) market in line with international best practices and the securities lending market.

2.3.4 Once the financial markets review has been completed, a Financial Markets Standard Group will be established to interact with market participants and similar standards bodies for the purpose of developing standards for the South African markets.

2.4 **Feedback from the Money Market Subcommittee and Reference Rate Working Group**

2.4.1 The Money Market Subcommittee (MMS) held a meeting on 11 September 2017 and the Reference Rate Working Group (RRWG) met on 4 October 2017 and 22 November 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 November 2017. During consultations with banks, asset managers and hedge funds it became clear that the project was 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. The Monetary Policy Implementation Framework (MPIF) is dependent on the finalisation of the reference rate consultation paper, which would recommend credible interest rate benchmarks. It was emphasised that the implementation framework would revolve around the ability of the SARB to influence money market rates (especially short-term rates) and the monitoring of effective monetary policy transmission. Once the framework is approved by the Executive of the SARB, consultation would take place with the relevant external stakeholders prior to implementation.

2.4.4 SIRESS balances

i. The National Payment Systems Department (NPSD) encouraged SIRESS members to leave funds in the account for operational purposes, which included the settlement of daily charges.

ii. Banks proposed that the SARB consider incorporating the SIRESS balances when determining whether to offer a supplementary repo at square-off. The SARB's supplementary auction facility is offered only when a change in autonomous factors (i.e. notes and coin in circulation, Corporation for Public Deposits (CPD) transactions and required cash reserves) exceed the R500 million threshold. The proposal was, however, being considered by the SARB.

2.4.5 Collateral management with Strate

i. Strate conducted a collateral management services and tri-party collateral feasibility test with commercial banks and the SARB. The feasibility test was on the substitution of collateral that has been lodged with the Financial Markets Department's (FMD) Collateral Management System (CMS) for the weekly repo. The weekly repo feasibility testing with the SARB and commercial banks was successful in enabling the 'central custody' for both the secured interbank and the weekly repo.

ii. The aim of the feasibility test was also to observe the functioning of the CBMS (the system that the SARB uses to conduct the auctions) and whether it will be possible to integrate FMD's CMS with the CBMS should the SARB eventually decide to subscribe to the Strate tri-party system.

iii. Banks were invited to submit proposals regarding the widening of eligible collateral for refinancing purposes. FMD will engage with the Committed Liquidity Facility Implementation Committee to discuss these proposals.

2.4.6 Accommodating the US dollar in SAMOS

i. The NPSD had a discussion with the Executive of the SARB regarding the inclusion of the US dollar in SAMOS, as requested by the FMLG. A working group was established to consider this; the first meeting will be held in January 2018.

2.4.7 The following resolutions were taken with regard to the money market yield curve with Treasurers of the banks:

i. Banks are generally comfortable with the Johannesburg Interbank Agreed Rate (Jibar) as a reference rate in its current format. However, they are not comfortable with the extension of the Jibar curve above the 12-month maturity. It was, therefore, agreed that there should be no extension of the Jibar curve. A new curve for longer-term maturities, to cover the requirements of both the buy and sell side of the market, should be developed with its own code of conduct. A working group would be established for the development of the new curve and a code of conduct. The working group would include the SARB, FSB, the Association for Savings and Investment South Africa (ASISA) and commercial banks. The JSE would be included during the final phase of the process.

2.4.8 Inclusion of negotiable certificate of deposit forwards in the Jibar Code of Conduct

i. According to the Jibar Code of Conduct, negotiable certificate of deposit (NCD) contributors' quotes are based on a T+0 settlement basis. The current Jibar Code of Conduct (Code) is silent on forward-starting NCDs.

ii. It was resolved that the Jibar Code should be amended to include forward-starting NCDs. All NCDs settling within seven business days following the trade date (i.e. up to T+7 settlement) should be subject to the Code. Given the difference between the trade and settlement dates, it was further resolved that, on the actual trade date, commercial banks' NCD screens should be adjusted to reflect the trade rates of all NCDs up to T+7 settlement. Any forward transaction(s) with a settlement date of greater than T+7 would be outside the Code.

2.4.9 Enhancing liquidity in the secondary market for Treasury bills

i. The Treasury Bill Market Working Group (TBMWG) proposed initiatives to enhance the liquidity in the secondary Treasury bill (TB) market. The TBMWG discussed, among other things, the development of a primary dealer system for the TB market; a buy- and sell-back market in TBs; the increase in the issuance of TBs across all maturities, including TBs of non-standard maturities; the expansion of the electronic trading platform (ETP) for government bonds to include TBs; and the introduction by the NT of a script-lending facility for TBs.

2.4.10 Reporting of overnight foreign exchange rates for the calculation of the South African Benchmark Overnight Rate

i. Not all banks report their funding in the foreign exchange (FX) market for the South African Benchmark Overnight Rate (Sabor) calculation. As a result, there could be a misalignment in the interpretation of funding from the FX swap market. It was resolved that commercial banks must report all FX forward transactions conducted to raise funding, including funding transferred to the treasury funding desk.

2.4.11 Revised Jibar Code

i. The process required to give the Reference Rate Oversight Committee (RROC) authority to approve revisions to the Jibar Code was completed. In future, the RROC will approve changes to the Jibar Code. All recent changes to the Jibar Code will be published on the SARB’s website in due course.

2.4.12 JSE’s use of Thomson Reuters and Bloomberg for Jibar calculation purposes

i The Jibar Code indicated that Bloomberg and/or Reuters should be used to calculate the Jibar. The JSE would use both Bloomberg and Reuters to harvest banks’ NCD rates to calculate the Jibar.

2.5 **Feedback from the Fixed Income and Derivatives Subcommittee**

2.5.1 The Fixed Income and Derivatives Subcommittee (FI&DS) met on 18 October 2017.

2.5.2 The FI&DS studied the MMS draft document on alternative overnight reference rates and will meet with the MMS to discuss a way forward.

2.5.3 The FI&DS concluded that it was not possible for the FI&DS to estimate the impact of the net stable funding ratio on derivative markets and the consequent impact on hedging costs. It was agreed that the Banking Association South Africa was better placed to assist with this analysis.

2.5.4 The London Clearing House (LCH) visited South Africa in November 2017 to discuss the implementation of single-period swaps. The LCH has prioritised increasing the maturity profile of rand-denominated swaps to beyond 10 years.

2.6 **Feedback from the Foreign Exchange Subcommittee**

2.6.1 The Foreign Exchange (FX) Subcommittee met on 10 October 2017.

2.6.2 The Global FX Committee published the Global Foreign Exchange Code (Global Code) in May 2017, which would govern market conduct.

2.6.3 Similar to other jurisdictions, South Africa will establish a stand-alone local FX Committee by February 2018, which would be structured in line with the recommendations of the Global Code. The FMLG's FX Subcommittee will cease to exist and the local FX Committee will no longer be a sub-structure of the FMLG. However, it is envisaged that the Chair and Deputy Chair of the local FX Committee will become members of the FMLG. The FMLG endorsed the decision to migrate the work of the FMLG FX Subcommittee to the new local FX Committee.

2.6.4 The terms of reference of the local FX Subcommittee are still being developed.

2.6.5 South Africa will host the Global FX Committee meeting in June 2018.

2.7 **Feedback from the Bond Market Development Committee**

2.7.1 The Twin Peaks legislation was signed in August 2017. The Twin Peaks legislation will have knock-on effects for the regulation of derivatives. The NT is on track to issue regulations on derivatives soon, which will include the licensing framework for a Central Counterparty Clearing House.

2.7.2 Implementation of the ETP project for South African government bonds

i. The Governors' Executive Committee of the SARB had approved the introduction of the ETP repo facility as part of the ETP settlement assurance framework. The general collateral repo rate was approved as the rate to be used by the SARB in providing liquidity through the ETP repo.

ii. The SARB was, however, still discussing the placement of margin calls with the Corporation for Public Deposits and the interest rate to be paid on these deposits.

Enquiries:

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Attendance of the FMLG meeting on 28 November 2017

Members who attended	Apologies from members
Daniel Mminele (Chairperson), **SARB** Edwin Makgopa, (Secretariat of the FMLG), **SARB** Taalya Phekun, **SARB** Leon Myburgh, **SARB** Callie Hugo, **SARB** Linda Motsumi**, SARB** Mukelani Nkuna, **SARB** Annemarie Britz, **SARB** Edward Leach**, SARB** James Cross, **SARB** Margaret Olivier, **SARB** Garth Klintworth, **Absa Capital** Deon Raju, **Absa Capital** Yeshveer Koobair, **Absa Capital** Richard Klonick, **Absa Capital** Andries du Toit, **FirstRand/RMB** Bhulesh Singh, **FirstRand/RMB** Theo Thomas, **FirstRand/RMB** Richard Farber, **IBA** James Glover, **Nedbank** George Kerby, **Nedbank** David Kinsey, **Standard Bank** Paul Burgoyne, **Standard Bank** Stuart Leslie, **Standard Bank** Roy Havemann, **NT** Clive Sindelman, **Investec** David Gracey, **Investec** **By invitation** Maria Vermaas, **Strate** Dale Connock**, Strate** Beverly Furman, **Strate** Nicky Newton-King, **JSE** Alicia Greenwood, **JSE**	Tim Masela, **SARB** Zafar Parker, **SARB** Muneer Ismail, **IBA** Andrew Hall, **Standard Bank** Lourens van Rensburg, **Investec** Johan Redelinghuys, **NT** Anthony Julies**, NT**