South African Reserve Bank

"The importance and development of sound Financial Market Infrastructures to position South Africa in SADC and Worldwide"

1. Introduction

Good afternoon ladies and gentlemen and welcome to our workshop on Principles for Financial Market Infrastructures.

I was initially only expected to introduce our Deputy Governor to welcome you and open this workshop but due to other pressing matters he is unable to join us this afternoon. As some of you are aware, the Bank's monetary policy committee meeting has been meeting for the past two days and will conclude all the relevant activities leading to a rates decision this afternoon.

I however expect us to have insightful discussions starting this afternoon leading to the first half of tomorrow. This workshop has been organised at an opportune time when South Africa is also undertaking regulatory reforms. South Africa produced a document entitled "A safer financial sector to serve South Arica better" early in 2011. This document acknowledges that the financial sector plays a central role in supporting the real economy but also introduces risks that would need to be managed. In the wake of the financial crisis, the international community embarked on initiatives that aim to improve regulation of the financial sector and foster financial stability. In these reform initiatives, although financial stability is key it is however not the only objective as a number of changes are also envisaged in the areas of market conduct, consumer protection as well as financial inclusion.

Engagements are underway among various regulators and stakeholders that will lead to the implementation of these regulatory reforms in the near future.

Safe and effective financial market infrastructures support the regulators' objective of ensuring financial stability. Systemic and prominent market infrastructures require appropriate regulation, supervision and oversight. It is thus imperative that relevant regulatory authorities have the oversight powers and resources to carry our this task. In exercising these powers, authorities should be transparent adopt relevant principles and apply them consistently. It is also crucial for central banks, market regulators and other authorities to cooperate in undertaking these tasks.

2. The importance of Financial Market Infrastructure

A disorderly failure in the financial market infrastructure can interrupt or impede the effective operation of markets, causing severe systemic disruptions and financial instability. As mentioned earlier, financial market infrastructures went largely unnoticed until the global financial crisis broke, and although they performed well through the crisis, it was only then that an appreciation was found for the true importance of such infrastructures, reflecting the fundamental role they play in ensuring financial stability.

With this in mind, in April 2012, the Committee on Payment and Settlement Systems at the Bank for International Settlements (CPSS) and the International Organization of Securities Commissions (IOSCO) published new international standards for payment and securities clearing and settlement systems, including central counterparties. The main objectives of the new principles are to ensure a robust global financial market infrastructure, which if faced with the financial shocks of the magnitude experienced in 2007/2008, will continue to operate effectively.

3. Financial Market Infrastructure developments in South Africa

It is important to indicate at the outset that financial market infrastructures in both the payment and securities markets, requires a collaborative approach from all the stakeholders. Clearing and settlement processes in both these areas involve the interaction of various parties, including participants, infrastructure providers and regulatory authorities, who all have an important role to play.

As early as 1993, discussions were initiated between the South African Reserve Bank (the Bank) and the banking industry to modernise and develop the domestic payment system. In this process, a strategic approach for the development of the payment system was adopted and meetings were held at different levels with various stakeholders, which culminated in the publication of the Framework and Strategy document for the National Payment System (commonly known as the “Blue Book”), in 1995. The Blue Book outlined various strategies envisioned for the payment system over the next ten years, leading up to 2005. The strategies addressed various aspects of payment system reform that had been identified, as well as the establishment of key pillars of the desired financial market infrastructures and appropriate supporting arrangements. One of the strategies, for example, relates to the establishment of a sound legal framework which culminated in the promulgation of the National Payment System (NPS) Act in October 1998. A review completed in 2003, revealed that all major payment system strategies that had been identified in the Blue Book had been achieved.

The South African payment industry has matured immensely since the launch of the Blue Book and subsequently two additional vision documents with a shorter time horizon of five years, namely, Vision 2010 and Vision 2015, were established to guide the development of the payment system into the future.

I would like to briefly sketch a broad outline of the payments industry in South Africa, before delving into the achievements made in the payment space since the introduction of the Blue Book.

At the end of August 2012, there were 24 active settlement participants in the South African Multiple Options Settlement system (SAMOS). The bulk of settlement happens in the real time stream, which captures over 90 per cent of settlements, the remainder accounted for by the retail stream. The latter has experienced a significant increase in electronic funds transfer (EFT) credits over the years, increasing from 58 per cent of the retail stream in 2005 to 74 per cent in 2011. There has also been a substantial decline in cheque usage, given that this is a relatively expensive payment instrument and much more vulnerable to fraud. In volume terms, the bulk of purchases at retailers are in cash (5.3 billion), as compared to credit (360 million) and debit cards (460 million). In value terms, however, the difference is less stark, as cash accounts for R332 billion worth of purchases at retailers, and credit and debit cards accounting for R134 billion and R120 billion respectively. As at December 2011, there were a total of 24 063 automatic teller machines and 277 478 point of sale devices. If one looks at the number of cards in issue, debit cards are by far the most widely used, amounting to 42 million out of a total number of cards in issuance of 62 million. Credit cards in issue are just under 8 million and gifts or pre-paid cards being the next highest at 5.8 million. The growth in the credit card industry has been hit by the global financial crisis, largely owing to more stringent borrowing terms and shrinking credit limits. The use of mobile devices by banks' clients, to access their accounts and to initiate/facilitate transactions, has also grown significantly over the past few years. These mobile devices include mobile phones and the various tablets available in the market today. There has also been a steady increase in the use of mobile phones to facilitate person to person payments/transfers.

Since the launch of the Blue Book, numerous achievements have been made. On 9 March 1998, the South African Multiple Options Settlement (SAMOS) system was implemented. Since then various upgrades have taken place to ensure that the settlement system is well- functioning, safe and efficient. Thus far during 2012, the average value settled through SAMOS on a monthly basis equates to approximately R7.3 trillion. In October 2008, at the height of the global financial crisis following the collapse of Lehman Brothers, a record settlement of R8.5 trillion took place.

The upgrades to the SAMOS system were undertaken in the interest of the financial system as a whole and in order to ensure South Africa's continued participation in the global financial arena. Some of these include facilities that enabled the integration of the payment system and securities clearing and settlement system. This enabled the South African financial markets to conform to international best practice with the introduction of the delivery versus payment (DVP) principle, as well as various other liquidity saving mechanisms to make settlement more efficient.

The low value Rand payment clearing systems have also evolved to current best practice and interfaces for these systems to the core SAMOS system have been established to ensure that settlement of all transactions is undertaken in central bank money and, as far as possible, the principle of same day settlement is achieved.

As was mentioned earlier, the NPS Act was promulgated in October 1998. The Act provided the SARB with the mandate to oversee the payment system and several amendments have been effected over time where necessary. Clearing and settlement agreements and rules have also been implemented as part of the objective of creating a sound legal and regulatory framework.

One of the most important achievements in the NPS was the inclusion of the South African rand in the Continuous Linked Settlement (CLS) system in 2004. CLS is a worldwide industry initiative implemented to reduce the risks associated with cross-currency transactions by settling the two legs of a foreign exchange (FX) transaction simultaneously in order to eliminate FX settlement risk[1].

---

[1] FX settlement risk is the risk that originates once a currency has been irrevocably paid by one party, and thereafter the counterparty fails to meet its obligation in the trade.

Leading up to the Rand joining the CLS settlement system, the SARB issued a position paper late in 2002 supporting the inclusion of the rand as a settlement currency in the CLS system and encouraged South African registered banks to support this initiative in areas where their actions were required to enable this initiative.

On 6 December 2004, CLS Bank International (CLS Bank) announced that four new currencies went live in the CLS system, one of them being the South African rand. At the time, this brought the number of currencies being settled through the CLS system at the end of 2004, to fifteen. This achievement ensured the integration of the domestic financial market infrastructure to the international system that enables our local participants to benefit from the risk reduction opportunities offered by the CLS system.

Another major project which is currently underway is the integration of the payment systems in the Southern African Development Community (SADC), so as to create a regional financial market infrastructure. The approach adopted in this process is to implement the desired infrastructure on a small scale, initially linking a few countries and thereafter rolling it out to more countries in a controlled manner. This will go a long way in facilitating trade within the region. International standards are adopted in this process to ensure that where appropriate in the future, the regional financial market infrastructure is enabled to integrate with other market infrastructures in other regions as well as internationally. It is envisaged that this infrastructure could be launched for testing as early as 2013.

It is imperative that domestic financial market infrastructures are developed with due consideration of international standards and best practice. This will enable integration with those operated by other countries and/or regions and thus facilitate cross border trade. Financial market infrastructures should endeavour to meet the highest standards of security, availability and operational effectiveness in order to retain the confidence of its users. In this regard, reputational risk is key in maintaining a high level of confidence and trust in the system.

Recently South Africa celebrated three decade of long association with the Society for Worldwide Interbank Financial telecommunication (SWIFT) which is used as a message carrier for financial transactions both domestically and internationally. We acknowledge SWIFT as a worldwide Financial Market Infrastructure and also indicate that South Africa has recently joined the SWIFT Oversight arrangement headed by the National Bank of Belgium.

4. Concluding remarks

Overall, the South African financial market infrastructures are well developed and always strive to meet international standards and best practice in order to be open for integration with other markets. Our participation in regional formations, international standard setting bodies and oversight arrangements also offers a platform for us to gain insight and learn from developments elsewhere. This also offers us an opportunity to make a contribution to these regional and international developments.

I thank you for the opportunity to share our experiences and look forward to interesting discussions in our sessions.