Financial Market Infrastructures oversight: The developments regarding the new financial dispensation in South Africa

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Agenda

1. Definitions
2. Background
3. Overview of the Principles for Financial Market Infrastructures (PFMIs)
4. Implementation of the PFMIs
5. Implementation Monitoring
6. The developments regarding the new financial dispensation in South Africa
7. Questions
Definitions

- **Financial Market Infrastructure (FMI)**
  - A multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling or recording payments, securities, derivatives or other financial transactions.

  BIS Updated: 16 Apr 2012
Definitions

- **Oversight**
  - A central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned payment, clearing, settlement and related arrangements, assessing them against these objectives and, where necessary, inducing change. These arrangements include financial market infrastructures and other payment, clearing, settlement and reporting arrangements and activities, both within and across jurisdictions (encompassing systems and activities involving large-value and retail payments, foreign exchange settlement, securities and derivatives clearing and settlement, multilateral netting and collateral management) as well as retail payment instruments or schemes. The scope of oversight differs between central banks but usually includes FMIs, with oversight being conducted domestically and through cross-border cooperation.

  BIS Updated: 16 Jun 2015
Background - OVERVIEW OF THE SA NPS
Background - The Landscape

CLS NETWORK

Central bank

SETTLEMENT NETWORK

SARB

CLEARING NETWORK

Non-clearing bank

CUSTOMER NETWORK

Retailer

BANKSERV

CUSTOMER NETWORK

Post Office

ATM

CUSTOMER NETWORK
Background - Oversight of Payment Systems

**Objective**

Reduce Settlement Risk:
- Legal Risk
- Liquidity Risk
- Credit Risk
- Reputational Risk
- Financial Risk
- Operational Risk

**Actions**
- Monitor
- Evaluate
- Advise
- Facilitate
- Implement
- Regulate
- Research & Development

**Scope**

Payment Systems:
- Clearing Systems
- Settlement System
- NPS Operators
- Payment Service Providers
- E-money Developments
Background - Oversight - Macro

- International Developments
  - Principles
  - Best Practice
  - Guidelines
  - NPS Act

- Observe/Monitor
  - Credit Risk
  - Liquidity
  - Legal
  - Operational
  - Reputational
  - Settlement

- Analyse & Evaluate
- Develop
- Implement

NPS

Bank

Equity Market

Bond Market

Retail Payments

CD

SARB

SAMOS

FIR

Bankserv
Financial Market Infrastructures (FMIs)

- Safe and efficient systems are critical to the effective functioning of financial markets as it is a channel to transfer funds.
- An FMI is a multilateral system among participating financial institutions, including the operator of the system, that handle significant transaction volumes and sizeable monetary values.
- FMIs play a critical role in fostering financial stability as it has the potential to cause major disruptions in the financial world and thus require robust systems.
- FMIs are used for the purpose of facilitating the clearing, settling or recording of payments, securities, derivatives, or other financial transactions.
- FMIs include systemically important payment systems (PSs), central securities depositories (CSDs), securities settlement systems (SSSs), central counterparties (CCPs) and trade repositories (TRs).
Experience during the financial crises

- FMIs generally proved resilient to the crisis due to the efforts of the last 20 years
  - Abnormally high settlement volumes managed during volatility
  - FMIs could cope with the default of a large counterparty
  - No materialisation of systemic risk in FMIs
  - Global efforts towards intraday finality were essential: RTGS, DvP and PvP

- However, the recent financial crisis also highlighted:
  - Significant counterparty credit risk in OTC derivatives markets
  - Severe lack of transparency in the OTC derivatives market and absence of infrastructure to mitigate risk
  - Insufficient (cross-border) information flow
  - Shortcomings in default and liquidity risk management
**Background (…continued)**

- **OTC Derivative Market Reforms**
  - G20 recommendations – Pittsburg Communiqué of September 2009
    - **Trading and Clearing:** All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs) by end 2012.
    - **Reporting:** OTC derivative contracts should be reported to trade repositories (TRs)
    - **Non-centrally cleared contracts** should be subject to higher capital requirements
  
  ➔ *Standard setting bodies should strengthen their risk management standards*

- Internationally agreed and accepted standards provide universal guidelines and promote the design and operation of safer and more efficient FMIs.
Development of the new PFMIs

- International standards for FMIs had been established since 2001:
  - The 2001 CPSS Core Principles for Systemically Important Payment Systems
  - The 2001 CPSS-IOSCO Recommendations for Securities Settlement Systems
  - The 2004 CPSS-IOSCO Recommendations for Central Counterparties

- A comprehensive review of the old sets of standards was launched in February 2010 by Committee on Payment and Market Infrastructures (CPMI) and International Organization for Securities Commission (IOSCO) to:
  - support G20 and FSB objectives to strengthen core financial infrastructures and markets by strengthening existing standards
  - incorporate lessons learnt from the recent financial crisis
  - promote consistent global enforcement across different FMI types, different FMI designs, and different jurisdictions
  - Provide revised responsibilities for authorities to oversee FMIs

- CPMI and IOSCO issued a consultative draft of the PFMIs in March 2011 and the final version of the new PFMIs published in April 2012
Overview of the Principles for FMIs

Table 1: General applicability of principles to specific types of FMIs

<table>
<thead>
<tr>
<th>Principle</th>
<th>Payment systems</th>
<th>CSDs and SSSs*</th>
<th>CCPs</th>
<th>TRs</th>
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<td>1: Legal basis</td>
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<td>2: Governance</td>
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<td>3: Framework for the comprehensive management of risks</td>
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<td>4: Credit risk</td>
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<td>5: Collateral</td>
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<td>6: Margin</td>
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<td>7: Liquidity risk</td>
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<td>9: Money settlements</td>
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<td>10: Physical deliveries</td>
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<td>11: Central securities depositories</td>
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<td>12: Exchange-of-value settlement systems</td>
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<td>13: Participant-default procedures</td>
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<td>14: Segregation and portability</td>
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<td>15: General business risk</td>
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<td>16: Custody and investment risk</td>
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<td>17: Operational risk</td>
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<td>20: FMI links</td>
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<td>21: Efficiency and effectiveness</td>
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<td>22: Communication procedures and standards</td>
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<td>23: Disclosure of rules and key procedures</td>
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<td>24: Disclosure of market data</td>
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* The applicability of certain principles for CSDs and SSSs will vary with the design of the FMI.
Responsibilities of Authorities

- Responsibility A: FMIs should be subject to appropriate and effective regulation, supervision, and oversight by a relevant authority
- Responsibility B: Authorities should have the powers and resources to carry out effectively their responsibilities in regulating, supervising, and overseeing FMIs
- Responsibility C: Authorities should clearly define and disclose their regulatory, supervisory, and oversight policies with respect to FMIs
- Responsibility D: Authorities should adopt and consistently apply the PFMI
- Responsibility E: Relevant authorities should cooperate, both domestically and internationally, as appropriate, in promoting the safety and efficiency of FMIs
Interaction between the principles

- The principles have significant interaction with each other and must be read holistically.
• Status of the PFMI:
  - Not legally binding as such but national regulation increasingly based on them (sometimes by way of incorporation) because of:
    - Power of the arguments they contain ("soft law")
    - Commitment of members of the relevant bodies (CPMI, IOSCO, FSB) to adopt the principles in the PFMI and put them into effect as soon as possible; FMIs are expected to observe the principles as soon as possible
  - Compliance of CCPs with the PFMI is a condition for banks to benefit from lower capital requirements
  - Basis of assessments by IMF and World Bank as part of the financial sector assessment programmes (FSAPs)
Co-operation of authorities

- Need to align conflicting objectives
- Need to promote consistency of regulatory requirements and approaches and avoid duplication
- Need for access to comprehensive and timely information on factors that may impact on the safety and resilience of infrastructures, institutions or markets
- Need for ex-ante clarification of responsibilities and procedures for cooperation among authorities during crisis situations

Arrangements can take many forms (e.g. based on mutually consistent regulation, bilateral or multilateral treaties, MoUs):

- Information-sharing arrangements
- Allocation of responsibilities (e.g. home/host supervision, lead overseer)
- Crisis management and resolution groups
Need for Global Consistency

- Who is subject to domestic rules (foreign linked FMI, participant or client)?
- Which transactions have a domestic relevance?

⇒ Consistency of outcomes of domestic regimes with the PFMIs across jurisdictions would minimise impact
The call for Action:

“Relevant authorities should strive to incorporate the principles and the responsibilities in this report in their legal and regulatory framework by the end of 2012.”

*PFMIs paragraph 1.30*
Implementation of the PFMIs

**SARB Process**

- In September 2013 the SARB through the NPSD publicly confirmed their support and commitment to implementation of the PFMIs through a Position Paper and Information Paper.
- The legal framework that would give effect to the policy commitments for the above-mentioned will stem from the Twin Peaks model that is currently in the process of being completed.
- SARB recognises the following stakeholders in the payment system that should adhere to the PFMI standards:
  - SAMOS system, which is SA’s RTGS system;
  - BankservAfrica Limited, which clears retail transactions;
  - STRATE which clears and settles equities, bonds and money-market transactions; and
  - SIRESS which settles cross-border credit transfers that require immediate settlement.
Implementation Monitoring

- **Current work**
  - Scope of the assessments covers all 24 Principles as well as Responsibilities A to E.
  - The results of the assessments are published on both CPMI and IOSCO websites.
  - The implementation monitoring covers all the jurisdictions with authorities that are members of the Financial Stability Board and/or the CPMI-IOSCO Steering Group that was responsible for the development of the PFMIs.
    - Argentina, Australia, Belgium, Brazil, Canada, Chile, China, European Union, France, Germany, Hong Kong SAR, Indonesia, India, Italy, Japan, Korea, Mexico, Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.
Implementation Monitoring (...continues)

- Reports published so far
  - Level 1: The First assessment report, First update and Second update
  - Level 2: The first Level 2 assessment reports
- Planned
  - A review of authorities' implementation of the Responsibilities is in progress and will be published in November 2015
  - A second set of Level 2 assessments against the principles have started in the second quarter of 2015.
  - Work on level 3 assessments is planned to start in this year.
Structure of IMSG Assessments

Structure of assessments is based on a Three Level approach:

Staged Approach to encourage completeness and consistency

- Jurisdictions have completed the process of adopting the legislation and other policies to implement the PFMIs within their regulatory framework
  - Self assessment by each jurisdiction

- The adopted measures are complete and consistent with the PFMIs
  - Peer Review: Assessment by the IMSG

- There is consistency in the outcomes arising from the implementation of the PFMIs across the jurisdictions
  - Thematic Review: Targeted assessments against selected principles by the IMSG
Level 1 Assessment of the Principles and Responsibilities

- Jurisdictional coverage: 28 Jurisdictions in total
Key question for Principles:
- To what extent jurisdictions have completed their regulatory framework to implement the 24 Principles (as applicable)?
- The Measures for implementation include: any legislations, rules, regulation, guidance, policy statements, other requirements, or combination of these, that are needed to enable the relevant authorities to require FMIs to observe the principles.

Key question for Responsibilities:
- Do the relevant authorities have complete legal capacity to carry out and act in accordance with the responsibilities?

Rating scale used:
- 1 – Draft implementation measures not implemented
- 2 – Draft implementation measures published
- 3 – Final implementation measures published
- 4 – Final implementation levels in force
Outcomes of Level 1 Assessment:
- The initial report of the Level 1 assessment published in August 2013
- The first update of the same report in May 2014.
- The second update to the Level 1 assessment was published in June 2015.

South Africa participated in these Level 1 assessments.
- CCPs – Rating of 4 (FSB published policy statement December 2012)
- PSs – Rating of 4 (SARB published policy statement September 2013)
- CSDs/SSSs - Rating of 4 (FSB published policy statement November 2012)
- TR – Rating of 1 (No existing TR, but measure is required)
- Same ratings apply for Responsibilities
Level 1 Assessments (…continued)

- Overall progress all jurisdictions by FMI type - Second update to Level 1 Assessment
Level 2 Assessment of Principles

- **Staged approach**
  - Scope of the assessment based on two criteria:
    - Jurisdictions where large global multicurrency CCP and TRs operate
    - Jurisdictions that received ratings of 4 for these FMI types
  - The content of implementation measures were assessed and not the FMIs
  - Key question:
    - Is the content of a jurisdiction’s regulatory framework consistent with the relevant principles?
  - 1st round the regulatory frameworks for CCP and TRs in three jurisdictions assessed:
    - USA, EU and Japan
  - These assessments were published in February 2015, subsequent rounds will be conducted in other jurisdictions and FMI types
  - South Africa not yet assessed in this regard
Level 3 Assessment of Responsibilities

- Scope of the assessment include all 28 jurisdictions at the same time
- Combined assessment approach using criteria of Level 2 and 3
- Key questions:
  - Whether adopted measures in a jurisdiction are consistent with the relevant Responsibilities for Authorities.
  - Whether the Authorities observe the Responsibilities in a complete and consistent manner
- These assessments were completed early August 2015 and is expected to be published by November 2015
- South Africa participated in this assessment and the preliminary results shows a good indication.
- Unpublished comment for South Africa: SARB was assessed to observe all Responsibilities for PSs and the FSB is assessed to observe all of the Responsibilities for CCPs and CSDs/SSSs except Responsibility E, which is assessed to be partly observed
The developments regarding the new financial dispensation in South Africa

- Establishment of a Financial Conduct Authority
  - Supervisory Conduct Standards
- Prudential Supervision of FMI
  - Supervisory Prudential Standards
- SARB responsibilities
  - FMIs
  - Non-FMIs
  - Overall FMI Policy
  - Oversight Standards
Thank you