Daniel Mminele: Ten years of inclusion of the South African rand in the CLS

Remarks by Mr Daniel Mminele, Deputy Governor of the South African Reserve Bank, at the Continuous Linked Settlement (CLS) Reception to mark ten years of inclusion of the South African rand in the CLS, Johannesburg, 17 March 2015.

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Good evening, ladies and gentlemen.

It is an honour for me to make a few remarks on this occasion of the CLS Reception to mark ten years of settlement of the rand in the CLS system.

I am particularly pleased that the CLS delegation to mark this key milestone is led by none other than the Chairman of the CLS Board, Mr Kenneth Harvey. We welcome you and your colleagues to South Africa, and thank you for coming all the way.

The CLS is one of those mission-critical systems that can be compared to the plumbing system of a building. Just as most of us never think about the plumbing of a building and take for granted that it is there and works, the CLS also runs very much in the background of the foreign-exchange market. It is only when there is a leak or a pipe bursts that we realise how important plumbing is. In the context of the CLS, if a big pipe bursts and cannot be fixed quickly, this can result in major disruptions to the foreign-exchange market, with potential rapid spill-over effects to the rest of the financial system, which at worst could bring about financial instability on a global scale.

As many of you will know, the CLS plays a fundamental role in the foreign-exchange market, where it operates the largest multi-currency cash settlement system to mitigate settlement risk for the foreign-exchange transactions of its members and their customers. In its offering, the CLS mitigates settlement risk through the provision of its unique payment-versus-payment settlement service which has direct links to the real-time gross settlement (RTGS) systems of the currencies it settles. In addition to mitigating settlement risk, the CLS also contributes to streamlining and standardising foreign-exchange operations, helping to reduce costs.

A foreign-exchange settlement usually requires potentially large cash funding liquidity to settle the obligations of settlement members. These values are materially reduced in the CLS system through the multilateral netting of the obligations between member banks to deliver best-in-class liquidity management. As regulatory requirements for larger liquidity buffers increase, the benefits from multilateral netting at an industry level have become increasingly important.

Before I briefly share with you how our participation in the CLS has grown over the years, allow me to go down memory lane for a short while.

Foreign-exchange settlement risk – being the risk that originates from a situation where, in a foreign-exchange trade, one party has irrevocably paid a currency and the counterparty subsequently fails to meet its side of the deal by not delivering the other currency on time – captured the attention of regulators as a major source of systemic risk following the spectacular collapse of Bankhaus Herstatt in Germany in 1974. The creation of the CLS goes back to regulatory concerns around the collapse of Bankhaus Herstatt.

In March 1996, the Committee on Payment and Settlement Systems (CPSS) at the Bank for International Settlements (BIS) published the so-called Allsopp Report titled *Settlement risk in foreign-exchange transactions – a strategy for addressing foreign-exchange settlement risk.* This report called for action from the private sector to address settlement risk in the foreign-exchange market. The response of the private sector led to the establishment of the CLS and the launch of the CLS system with 39 members and seven currencies: the

Australian dollar, Canadian dollar, euro, Japanese yen, Swiss franc, UK pound sterling, and US dollar in September 2002.

Since then, the system has evolved to the current state where foreign-exchange transactions in 17 currencies are settled with a peak volume to date of over 2 million transactions per day and a peak value of more than US$10 trillion per day. In its evolution, the CLS added four more currencies in September 2003: the Danish krone, Norwegian krone, Singapore dollar, and Swedish krona. In December 2004, a further four currencies were added to the settlement service, namely the Hong Kong dollar, Korean won, New Zealand dollar, and South African rand. The currencies of Israel and Mexico were implemented on the system in 2008.

Joining the CLS in 2004 was a major achievement for South Africa given the stringent eligibility criteria. In briefing Parliament at the time about the risk management, liquidity, and efficiency benefits of the CLS system, then Minister of Finance, Mr Trevor Manuel, put it rather succinctly, and I quote: "The inclusion (…) demonstrates that the South African payment system provides for global best practice, and would foster domestic and international investor confidence in the integrity and robustness of the national payment system."

Back in December 2004, our central bank joined the CLS Cooperative Oversight arrangement led by the Federal Reserve Bank of New York, as the regulator of the CLS Bank, in order to ensure that, in the settlement of the rand in the CLS system, our domestic policy objectives continued to be met.

We also joined the CLS Operators Forum, also led by the Federal Reserve Bank of New York, to ensure the coordination of relevant actions by all real-time gross settlement system operators that are linked to the CLS system. In all these cooperative arrangements, there is an appreciation of regular interaction as well as frank and constructive engagement with CLS management and executives.

Before I conclude, let me share some information on our participation in the CLS system. In 2004, when we joined the system, two of our banks, namely Absa and Standard Bank, became settlement members. These banks had obtained direct access to the CLS system in terms of submitting their foreign-exchange trades. Absa has, however, since become a member of the Barclays Group and its membership has thus been terminated. It is now a submitting branch of Barclays in the CLS system. At the time, we had six Rand Nostro service providers, namely Absa, Calyon, CITI, FirstRand Bank, Nedbank, and Standard Bank. These banks provide services to CLS members in terms of either receiving rands that are purchased and settled through the CLS system or funding rands that are sold and settled through the CLS system. In terms of rand settlement members, they are in a position to receive and fund rands for their own account.

As far as rand settlement in the CLS system is concerned, during 2005, an average of R83 billion worth of rand trades were settled in the CLS system on a daily basis. To settle these trades, the average daily liquidity requirement that needed to be paid into the CLS system through the SAMOS system amounted to only R6,2 billion. This resulted in a liquidity efficiency of 7,5 per cent. By 2009, the average values of rand trades that were settled in the CLS system on a daily basis had grown to R163 billion. To settle these trades, the average daily liquidity requirement that needed to be paid into the CLS system through the SAMOS system amounted to only R9 billion. This resulted in a liquidity efficiency of 5,5 per cent. More recently, during 2014, the average values of rand trades that were settled in the CLS system on a daily basis amounted to R411 billion. To settle these trades, the average daily liquidity requirement that needed to be paid into the CLS system through the SAMOS system amounted to only R8.7 billion. This resulted in a liquidity efficiency of 2,1 per cent.

Thus, in the ten years of South African participation in the CLS, the average daily value of transactions settled has increased fivefold, with only a 40 per cent increase in pay-in values. From these statistics it is evident that while our market is benefiting from the risk management mechanism provided by the CLS system, there are also huge benefits that we gain from the liquidity efficiency.

Among the many things highlighted by the global financial crisis was the realisation that there are certain critical, systemically important systems in the international payment and settlement environment which deserve special attention going forward. The CLS is one of them, and in this vein we in South Africa remain committed to building on our good relationship with the CLS and other fellow regulators as well as relevant international bodies, such as the Committee on Payments and Market Infrastructures (CPMI), to ensure the we continue to strengthen the system further so as to reduce the potential for systemic disruption and financial instability.

As you may be aware, we are also actively engaged in implementing cross- border settlement arrangements and systems within the Southern African Development Community (SADC), and our experiences from working with the CLS are proving quite useful.

To our stakeholders in the South African national payment system, the CLS Group, and, last but not least, my colleagues at the South African Reserve Bank and other regulators, all the best for the next ten years and more!