

# INFORMATION PAPER

## NPS 01

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### INTRADAY FUNDING AND COLLATERAL POLICY IN THE SAMOS SYSTEM

#### Executive summary

1.	This document outlines the South African Reserve Bank's (Reserve Bank) approach towards, and policy on intraday funding and collateral with regard to the SAMOS system.
2.	Position Paper 2/97 issued by this Office is hereby withdrawn and replaced by Information Paper NPS 01. This step was taken to ensure that banks and other participants in the payment, clearing and settlement system are in no doubt about which administrative directives and guidelines regarding the application and interpretation of the provisions of the National Payment System Act, 1998 (Act No. 78 of 1998), are in force at a particular time, and to avoid an accumulation of ephemeral matter.

## 1. INTRODUCTION

One of the main objectives of the National Payment System (NPS) Framework and Strategy document, accepted for implementation by the banking industry on 15 November 1995, was to reduce systemic risk in the South African payment system. To this end, a number of fundamental principles were formulated, including the following:

- Settlement will be subject to the availability of funds;
- a balance will be maintained between risk reduction and cost;
- the Reserve Bank's response to a problem in the NPS will be in the interest of the system, not that of individual participants.

The NPS Framework and Strategy document furthermore prescribes two strategies specifically aimed at reducing interbank settlement risk, namely the introduction of an online central bank settlement system so as to enable banks to transfer interbank funds electronically, and the implementation of risk-reduction measures in the Payment Clearing Houses (PCHs).<sup>1</sup>

The Reserve Bank implemented the South African Multiple Option Settlement (SAMOS) system on 9 March 1998. The SAMOS system provides two primary settlement options to banks, namely: Real-Time Gross Settlement (RTGS), referred to in the SAMOS system as the Real-Time Line (RTL), and the continuous processing line (CPL) settlement. A description of each option appears below.

- The Real-Time Line (RTL) is a facility for settling single-settlement instructions immediately on a gross basis.
- The Continuous Processing Line (CPL) is a delayed settlement facility developed to settle single-settlement instructions on a gross basis, utilising net liquidity. The CPL account is funded from the settlement account.

The SAMOS system settles on a pre-funded basis. If a bank has insufficient funds available in its settlement account, the SAMOS system will automatically grant a loan to the bank against acceptable collateral. The amount of such a loan is limited to the collateral value of the collateral reserved for this purpose.

In support of the above-mentioned principles and strategies, this document provides the Reserve Bank's policy regarding the funding of settlement accounts and the collateralisation of the intraday loans that the Reserve Bank extends to banks for settlement account funding purposes in the SAMOS system.

## 2. COLLATERAL POLICY FOR SETTLEMENT ARRANGEMENTS

The Reserve Bank provides banks with liquidity for settlement purposes in the SAMOS system through the SAMOS loan facility which must be collateralised by the same type of collateral as that required in the Monetary Policy Operational Notice [/- Note2](#).<sup>2</sup> The Monetary Policy Operational Notice may be amended from time to time and its requirements for collateral will be applied accordingly.

### **3. THE RESERVE BANK'S POLICY ON THE FUNDING AND COLLATERALISATION OF INTRADAY SETTLEMENT**

The Reserve Bank has the following policy on the funding and collateralisation of intraday settlement:

#### **3.1 Securing of SAMOS loans**

In line with the Monetary Policy Operational Notice, all intraday loans granted by the Reserve Bank for settlement purposes will have to be fully secured by the pledging of acceptable collateral.

In order to allow the Reserve Bank to provide the automated intraday SAMOS loan facility, only acceptable financial instruments may be reserved by the banks for use in SAMOS. Only instruments held in the Reserve Bank or a recognised Central Depository (CD) may be utilised for this purpose.

#### **3.2 Funding of settlement accounts**

Settlement in the SAMOS system is based on the pre-funding principle, in terms of which an interbank fund transfer will be effected only if sufficient funds are available in the paying bank's settlement account. The settlement account can be funded in a number of ways, *inter alia*:

##### **3.2.1 Receipt of payment from another bank**

Payments will be received from the Reserve Bank and participating banks as a result of normal payment transactions between banks or a credit arrangement. In the last-mentioned case, a bank experiencing a liquidity shortage would, therefore, be able to approach another bank for a loan and receive a real-time payment in its settlement account by means of a "credit-push" transaction from the bank granting the credit facility.

##### **3.2.2 Raising of automatic intraday SAMOS loans**

The SAMOS system contains a dynamic collateral-management component which enables a bank to obtain an intraday loan from the Reserve Bank automatically if it has reserved the necessary acceptable financial instruments available in the system for use as collateral. This system also has an option to repay the loan automatically and to release the pledged collateral on receipt of incoming payments.

#### **3.3 Collateralisation of intraday SAMOS loans**

Intraday SAMOS loans shall be secured by the same type of collateral as that used under the Monetary Policy Operational Notice. Acceptable Financial Instruments are defined by the Monetary Policy Operational Notice as Government stock, Reserve Bank debentures, Treasury bills and Land Bank bills (irrespective of maturity). These instruments can be reserved as collateral in the SAMOS system. This collateral will automatically be utilised for securing SAMOS loans, on the conditions

determined by the Reserve Bank from time to time, in order to facilitate settlement through the SAMOS system if there is a shortage of funds in a bank's settlement account.

### **3.4 Intraday utilisation of the liquid-asset requirement holdings of banks**

The Registrar of Banks made a concession to allow banks to use 50 per cent [/- Note3](#)<sup>3)</sup> of their liquid-asset requirement holdings during the day as collateral for intraday SAMOS loans for facilitating interbank settlements. During the day, a bank could, therefore, reduce its holdings of required liquid assets to levels below those required by the Banks Act, 1990, but would have to meet the prescribed liquid asset requirements again by the end of the day. However, the Registrar of Banks has the discretion to apply such use of liquid-asset requirement holdings selectively, in order to restrict or withdraw a particular participant's, or all participants' use thereof, if in the Registrar's opinion this arrangement adversely affects the risk profile of a particular bank or the banking industry as a whole. Any change to this arrangement will take effect at the beginning of a new settlement cycle, that is, the opening of the SAMOS system for a new business day.

### **3.5 The utilisation of the [Cash Reserve holdings](#) at the Reserve Bank**

The Reserve Bank introduced the Cash Reserve Contra Account (CRCA) arrangement with effect from 20 March 1998 to allow banks greater flexibility in managing their daily liquidity. In essence, the introduction of the CRCA enables banks to comply with the statutory cash reserve requirements on an average basis over each maintenance period [/- Note4](#)<sup>4)</sup>.

#### **3.5.1 Intraday utilisation**

Banks are allowed to utilise their required cash reserve holdings fully during the day for intraday liquidity but the banks still have to meet the requirements for their cash reserve holdings over the monthly maintenance period. Any movements against the CRCA will be recorded, and the average balance will be calculated. Banks have to ensure that the average balances meet the minimum requirement for cash reserve holdings.

There is also a facility through which the banks may request that their CRCA balance be reserved in the SAMOS system. This facility will provide additional liquidity to settle any unexpected "spikes" in the PCH batches.

### **3.6 Market-risk premium**

To provide for volatility in the market values of financial instruments, the SAMOS system has a volatility or market-risk premium that will apply. This rate is normally 105 per cent and will be used to calculate the collateral value of each instrument based on the previous day's market value. The SAMOS system calculates the collateral value of the financial instruments at the start of each business day. When a loan is granted, the SAMOS system will pledge collateral with a collateral value that is equal to the amount of the loan required.

### **3.7 Intraday interest**

No interest will be charged or paid on intraday account balances. This arrangement will only be changed after consultation with the banking industry and all relevant stakeholders.

## **4. LEVEL OF LIQUIDITY AND ACCEPTABLE INSTRUMENTS**

Within the scope of the monetary policy objectives applicable to end-of-day positions, the Reserve Bank will take steps to ensure that enough liquidity and/or a sufficient level of acceptable securities is available to facilitate the smooth functioning of the settlement system.

Banks will be advised in good time of changes to the intraday funding and collateral policy to ensure the smooth implementation of the changes and to limit the impact of policy changes on the national payment system.

## **5. CONCLUSION**

The intraday collateralisation measures provide ample opportunities for banks to effect settlement in real time. The SAMOS system facilitates transfers of interbank funds and allows banks to monitor their settlement exposures. This improves the overall risk management in the interbank settlement system and enables the Reserve Bank to improve the settlement-risk management and, therefore, reduce the potential for crises.

1. Position paper 01/2000: Position Paper on Risk Reduction Measures for Payment Clearing Houses in the NPS, issued 2000-09-01
2. Repurchase Operations in the Domestic Money Markets: Operational Notice of 2 February 2001
3. Notwithstanding the withdrawal of Banks Act Circular 10/98 (Amendments to the Regulations relating to Banks and Regulations relating to Mutual Banks), the guidelines contained in paragraph 3 of the circular are retained. This concession may change from time to time
4. A maintenance period starts on the 15th working day of a month and ends on the 14th working day of the following month