national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA STATEMENT

Electronic Trading Platform for RSA Government Bonds

The National Treasury will implement an electronic trading platform (“ETP”) for the Primary Dealers (“PDs”) where the secondary market quoting obligations under the Primary Dealer contract will need to be satisfied on the ETP. The primary reasons for this decision are to enhance the transparency within the South African Bond Market and to enable NT to more accurately monitor the activities of the PDs.

1 BACKGROUND

In 2012 National Treasury (“NT”) formed an industry-wide committee called the Bond Market Development Committee (“BMDC”). The mandate of this forum is to look at development issues facing the South African bond market. It has representation from across the industry, including the Johannesburg Stock Exchange (JSE), Strate, the Association for Savings and Investment South Africa (“ASISA”), the South African Reserve Bank (“SARB”), the Financial Services Board (“FSB”), the Primary Dealers Association (“PDA”) and individual members of the JSE.

As a result of the work undertaken by the BMDC, and collaboration with the World Bank, NT will implement the ETP. Under the terms of the Financial Markets Act No. 19 of 2012 (FMA), such an electronic market is required to be licenced as an exchange so NT has entered into an agreement with the JSE whereby the JSE as a licensed exchange under the Financial Markets Act, No.19 of 2012 will provide this ETP market.

The Registrar of Securities Services (Registrar) at the Financial Services Board (FSB) supervises and enforces compliance with the FMA and remains the regulator of the JSE. The JSE will deliver the ETP market under its existing exchange license. Under the FMA, the exchange is responsible for issuing the rules for the markets which it operates (of which this will be one) and supervising compliance with and enforcing such rules. The JSE will therefore be the front-line regulator for this market. The market will operate in parallel to the existing JSE reported market for government bonds where other market participants, including the PDs will continue trading as they currently do.

Within the structure of the agreement with NT, the ETP Market Committee (“Market Committee”), chaired by NT and comprised of representatives from industry namely, PDA, SARB, JSE and ASISA, is responsible for determining the framework (operating model) for this market. The JSE rules will give effect to the framework agreed to by the Market Committee and must be approved by the Registrar. The Market Committee is also responsible for defining the core functional and other requirements of the ETP.

2 CURRENT STATUS

There are four dedicated working groups focusing on the implementation of the ETP:

2.1 Primary Dealer Obligations and Incentives

This is a bilateral process between NT as issuer of RSA Government bonds and the PDA. The details of these contract negotiations are confidential however the following can be communicated:

1) PDs will have obligations both in the primary market and the secondary market. One of the secondary market obligations will be that the appointed PDs will stream two-way (buy and sell) quotes onto the ETP.
2) The nature of the quote obligations will determine:
   a) The bonds subject to this quoting obligation
   b) The minimum size of the quote
   c) The maximum spread between the buy and sell quote
   d) The minimum time that quotes need to be displayed
3) NT may also build incentives into the contract to attract volumes onto the ETP.
4) These contract negotiations are close to being finalised.

The JSE, with the approval of the Market Committee, may add bonds to the list eligible for quoting and trading on the ETP. These bonds will not be subject to mandatory quoting obligations as described above, however the listing of such bonds will assist with market transparency should ETP participants choose to quote on these bonds.

2.2 Settlement Model and Assurance

The ETP is intended to form a critical part of the SA bond market ecosystem through facilitating transparency at the core of the market. In market architecture terms the core is defined to be the volumes between the Primary Dealers and other professional market-maker banks. The current design for the ETP is that quotes by participants on the ETP will be anonymous. This pre-trade anonymity is new for the market and yet is an accepted design for most electronic markets. Post the matching of a trade on the ETP, the parties to that trade will be notified of the other party to the trade. This will NOT be disclosed to other participants or the market.

The market design implies that ETP participants are expected to trade with impunity and therefore need to have open trading lines with other ETP participants. This is not the prevailing model in the JSE reported market or the offshore market where market participants allocate trading lines to each other based on internal credit processes. NT, the SARB, the JSE, Strate and key representatives from the settlement banks are working through the legal, regulatory, operational and risk issues raised by the proposed trading model so that under all circumstances, including the default of an ETP participant, outstanding matched trades will settle. Post trade reporting will be made available to the entire market with the details still to be finalised.

The final settlement design will be completed before the process to actually select and implement the ETP is initiated.

2.3 Regulation and Rules

The JSE will be the front-line supervisor of the ETP market. The ETP will have its own set of rules under the JSE exchange licence. A framework for the creation of these rules has been completed. The structure of these rules will take into account the unique features of this market, for example whether:

1) There are any qualifying membership criteria that support the trading and settlement model, for example capital.
2) Participation on the ETP is limited to any specific type of entity based on their business model.
3) Specific obligations are imposed on an ETP participant, for example quoting obligations.

The Market Committee will review the rules before they are promulgated, in accordance with the standard process contemplated in the FMA. This by definition will include a public consultation process and will require approval by the FSB.

2.4 Technology Selection

The JSE and the Market Committee are currently in the process of evaluating responses from 12 suppliers in response to a Request for Information ("RFI") document. The evaluation panel includes representatives from each PD, JSE and NT. The panel will be evaluating the response for functional fit, technological fit and value-add services offered by the respondent. By the end of October 2014, the Committee will short-list the potential suppliers that are best suited to building the ETP. This short-list will then be included in a detailed Request for Proposal ("RFP") process to complete detailed design and costing. ASISA will also participate in this part of the process. One supplier from this short-list will be selected to provide the ETP technology.

FREQUENTLY ASKED QUESTIONS

This project, by its very nature has raised a number of questions from various quarters. The FAQ below is an attempt to answer those questions that may not have been answered in the sections above:

1) **Why is the ETP being implemented as contemplated?**
   There are many ways to design a government bond market. Each jurisdiction has design features unique to that market's history. From a market architecture perspective the ETP market model that is being implemented is aligned with the market model in Europe. This recognises the role of PDs in the market architecture and yet moves a proportion of the activity that is created by PDs from a less-transparent bilateral market to a more transparent electronic venue.

2) **Who can participate in trading on the ETP?**
   Phase I of the project will limit participation on the ETP to the PDs appointed by NT. It is contemplated that in a second stage it may be possible to include non-PD banks who voluntarily subject themselves to the quoting obligations imposed by NT under the PD agreement. Such market-makers will not be subject to the obligations in the primary market where NT issues bonds. In the long-term, the market model contemplates the admission of "price takers", i.e. participants who can only access the resting quotes on the order book. The nature of such participants has yet to be decided. Such a decision will be made through the Market Committee governance process and will be affected by the settlement model that is in place. The role of foreign market-makers in the ETP has yet to be considered. Enabling such participants requires the promulgation of Ministerial Regulations in respect of External Authorised Users under the FMA.

3) **Is participation mandatory?**
   Yes it is, for Primary Dealers appointed by NT.

4) **How does the ETP fit in with the existing market operated by the JSE, where trades are executed off order book and reported to the JSE for matching and settlement?**
   As in other jurisdictions, the bond market is more than the ETP and the market reach of SA Government bonds and the participant's active in them is global. The JSE also operates the existing market where locally domiciled market participants are required either to be an Authorised User of a licenced exchange (an FMA term) or to report all transactions in bonds through an Authorised User of a licenced exchange. This market negotiates transactions bilaterally and then reports the transactions to the JSE for matching and routing to Strate for settlement. This market is subject to a set of exchange rules called the JSE Interest Rates and Currencies Rules (the IRC Rules). The ETP market will require a separate set of rules to govern the activity of participants on the ETP. In addition the IRC rules may need to evolve to take into account the implementation of the ETP as well as any additional requirements that have arisen due to the implementation of the FMA. The settlement impact of the additional ETP trading venue on overall bond settlements including the JSE reported market and Strate OTS settlement (settlement between two non-SA residents) is being discussed within the Settlement work stream. The ETP settlement will run in parallel to these other settlement environments.

5) **What will the fee structure be for trading on the ETP?**
This is unknown at this time and will be affected by the costs charged by the supplier selected to build the ETP, the overall design and the costs of integrating the ETP into the IT architecture of the JSE and Strate.

6) **What timelines are contemplated for implementation of the ETP?**
The project is still at an RFI stage so this is unknown at this time. The timeline will be determined during the detailed design phase post the RFP and will also need to take into account other large industry projects in the pipeline, for example the T+3 project for the cash equities market.

7) **Who will have access to the live market data from the ETP?**
The final model for the dissemination of the market data on the ETP has yet to be decided. As one of the key objectives of this project is to increase public transparency in the market, the ETP will not be a dark venue where prices are only available to market participants. A subscription fee may be levied on those accessing the data.

8) **How will the bond market statistics take into account the volumes on the ETP?**
The JSE currently produces a detailed set of information on activity and volumes in the SA bond market that is reported to the JSE. The ETP will simply be another venue that generates data and the associated statistics. It is likely that a set of data will specifically be produced for ETP trades alongside the current data. The sum of these two datasets will represent the total market operated by the JSE.

9) **Will the ETP allow for trading of non RSA Government bonds?**
At this time it is only contemplated to allow for the trading of RSA Government bonds. The unique nature of the ETP market and its associated settlement model must be highlighted, i.e. a market specifically for PDs appointed by NT where aspects of the secondary market obligations of these PDs can be monitored in real time and in a transparent manner. The extension of trading to other bonds or types of interest rate instruments would need to take these features into account.

10) **How does the technology for this project relate to the Integrated Trading and Clearing project announced by the JSE whereby the JSE will be replacing the current technology for the reported bond market?**
As part of its Integrated Trading and Clearing project, the JSE is replacing its trading and clearing technology for all non-equities asset classes with technology provided by Millennium IT and Cinnober respectively. However, as part of its commitment to the ETP project, the JSE has agreed with NT that it will consider a range of potential suppliers for the ETP. The PDs and ASISA are all invited to be part of the RFI and RFP process. The final decision on selecting the vendor to implement the ETP rests jointly with the JSE and National Treasury as the JSE will be contracting with the selected vendor and NT is the entity requesting that this new ETP market be built. The cost impact of the final decision and how the ETP system fits into the broader bond market ecosystem will be important selection criteria.

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