



JOINT DISCUSSION DOCUMENT

**EXPANSION OF ELIGIBLE COLLATERAL TYPES
AND REGULATORY REPORTING
REQUIREMENTS**

**Determinations to be issued in terms of Joint Standard 2 of 2020:
Margin Requirements for non-centrally cleared over-the-counter
derivative transactions (amended) made under
the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017)**

AUGUST 2022

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1. Purpose

- 1.1 The purpose of this discussion document is to communicate proposals by the Financial Sector Conduct Authority (FSCA) and the Prudential Authority (PA) (hereafter, jointly referred to as the Authorities), in relation to matters contained in Joint Standard 2 of 2020: Margin requirements for non-centrally cleared over-the-counter (OTC) derivative transactions¹ (Joint Standard)². The proposals consider:
- (a) the expansion of eligible collateral types as referred to in paragraph 6(2) of the Joint Standard; and
 - (b) regulatory reporting requirements to be placed upon providers and counterparties³.

2. Background

- 2.1 In 2015, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) jointly published a policy framework on the margin requirements for non-centrally cleared OTC derivatives (policy framework)⁴. The BCBS and IOSCO policy framework consider the types of collateral that should be deemed as eligible in satisfying margin requirements and evaluates several different approaches that may be implemented in deriving an appropriate collateral set. The policy framework required national supervisors to develop their own list of eligible collateral types based on prescribed key principles and stipulated considerations, as well as the conditions and market dynamics prevalent in their respective jurisdictions. The BCBS-IOSCO framework considered an approach for the use of high-quality liquid assets as eligible collateral, such as cash and high-quality sovereign debt, to ensure that the value of such collateral could be fully realised when held as margin during periods of financial stress. The BCBS-IOSCO framework also considered a

¹ <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-financial/sector-regulation-joint-standards/2020/9975>

² Please note that the proposed draft amendments to the Joint Standard is out for consultation and this Joint Discussion Document relates to proposals on the determination of expansion of eligible collateral types and regulatory reporting requirements enabled by the draft amendments.

³ As defined in the Joint Standard.

⁴ <https://www.bis.org/bcbs/publ/d475.htm>

broader set of eligible collateral types, such as liquid equity securities and corporate bonds, but for which the potential volatility of such assets may be addressed through the application of appropriate haircuts to their valuation in satisfying margin requirements.

- 2.2 On 2 June 2020, the Authorities published the Joint Standard, which came into effect on 16 August 2021⁵.
- 2.3 Paragraph 6(2) of the Joint Standard explicitly specifies cash and gold as the permissible eligible collateral types. However, paragraph 6(2) of the Joint Standard is also enabling in its construct, by providing for the Authorities to specify, in writing, other assets or instruments that may constitute eligible collateral for purposes of satisfying initial and variation margin requirements.
- 2.4 In its current form, the Joint Standard does not fully permit the Authorities to determine or impose conditions on risk management, internal control and assurance requirements related to the use of non-cash collateral, and regulatory reporting requirements. This prompted the Authorities to propose amendments to the Joint Standard to enable the imposition of appropriate risk mitigation requirements for providers wanting to make use of non-cash collateral and to enable the Authorities to determine specific regulatory reporting for providers and counterparties. The proposed amendments and supporting documents were published for public consultation on the websites of the Authorities on 13 June 2022, with comments due on or before 25 July 2022.⁶
- 2.5 Accordingly, once the Joint Standard is amended to include the proposed amendments, as specified in paragraph 2.4 above, the Authorities will set out to expand eligible collateral types beyond cash and gold, and institute the relevant regulatory reporting requirements, as set out in this discussion document.
- 2.6 It is expected that any such expansion of eligible collateral types and specification of regulatory reporting requirements will be done through the publication of a determination by notice on the respective websites of the Authorities.
- 2.7 As part of the process toward expanding eligible collateral types beyond cash and gold, the Authorities are considering the imposition of necessary measures to mitigate the risks involved in the use of such non-cash collateral. As explained in paragraph 2.4 above, the proposed amendments to the Joint Standard will enable the Authorities to make use of the specified collateral by providers and counterparties, conditional to the necessary risk management, internal control, and assurances requirements. Further technical work is being undertaken by the

⁵ <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-financial-market-infrastructure/market-infrastructure-joint-standards/2021/Joint-Communication-2-of-2021---Det-effective-date-of-JS-Margin-Requirements>

⁶ <https://www.fsca.co.za/Regulatory%20Frameworks/Documents%20for%20Consultation/NoticeDraft%20amendment%20to%20Joint%20Standard%20of%202020-Margin%20Requirements.zip>

Authorities to develop these requirements, with the intention of communicating the proposed conditions for the expansion of collateral to the industry in due course, prior to the publication of the final determination by notice on the respective websites of the Authorities. These conditions are intended to be supplementary in nature and would consider existing market and regulatory practices toward ensuring that the risks involved in the use of such non-cash collateral are mitigated.

3. Proposals

3.1 Proposal to expand eligible collateral

3.1.1 The Authorities have formulated a phased strategy to systematically expand eligible collateral types for use by providers and counterparties in satisfying margin requirements. This strategy considered the BCBS-IOSCO framework key principles noted in paragraph 2.1 above, together with an assessment of collateral usage and conditions in the South African financial sector across liquidity risk, credit risk, and counterparty credit risk frameworks, exchange-traded derivatives⁷ (ETD) and OTC market practices, foreign jurisdictions' central counterparty practices and other such international best practice. Given that cash (and gold) is considered eligible collateral in the Joint Standard, the Authorities have considered high-quality sovereign bonds as the next appropriate eligible collateral type against the BCBS-IOSCO framework principles and within the context of the current regulatory frameworks and market practice noted above.

3.1.2 As a result, the Authorities hereby propose that high-quality liquid bonds issued by the South African central government that are assigned a rating of BB- or higher by an eligible external credit assessment institution⁸ (ECAI)⁹, should be recognised as eligible collateral in satisfying either initial or variation margin requirements.

3.1.3 This proposal will be subject to the imposition of certain risk management conditions, which will be consulted on separately by the Authorities.

3.1.4 In due course, the Authorities will propose other eligible collateral types for consideration (including liquid equity securities and corporate bonds), based on the phased strategy and a similar assessment as mentioned in paragraph 3.1.1.

⁷ The JSE Clear which serves as the clearinghouse for all JSE Derivatives Markets prescribes ZAR cash as the only permissible collateral for ETD transactions. In the JSE Clear collateral policy document² published in 2018, the clearinghouse stated that it will consider market and price liquidity of the particular security as well as the interdependence between the pledger and security in question when evaluating eligible collateral types. Only liquid, South African fixed rate government bonds were under consideration as acceptable collateral by the JSE Clear.

⁸ Section 85A of the Banks Act, 1990 (Act No. 94 of 1990) stipulates that no bank or controlling company may in the calculation of its minimum required capital and reserve funds, take into account a credit assessment of an ECAI or export credit agency unless such ECAI or export credit agency has obtained the prior approval of the PA to act as an eligible institution.

⁹ List of Credit Rating Agencies registered in accordance with Section 5(1) of the Credit Rating Services Act, 24 of 2012 available at: <https://www.fsca.co.za/Regulated%20Entities/Pages/Credit-Rating-Agencies.aspx>

3.2 Regulatory reporting requirements for margin requirements

- 3.2.1 The amendments to the Joint Standard, once made effective, will enable the Authorities to impose regulatory reporting requirements on providers and counterparties related to the requirements in the Joint Standard. The amendments will allow the Authorities to determine the content of the reporting, as well as the form, manner and frequency of such reporting, by notice on the websites of the Authorities.
- 3.2.2 In order to enable effective supervision of the Joint Standard (once the aforementioned amendments take effect), the Authorities have developed a set of regulatory reporting requirements, comprising of two phases.
- 3.2.3 Phase one related to an interim tactical solution, whereby institutions submit regulatory reporting data on a given Microsoft Excel spreadsheet. All technological requirements of the tactical solution were communicated and implemented, with the solution now effective for certain providers.
- 3.2.4 Phase two relates to a long-term strategic solution, whereby institutions must submit regulatory reporting data into a dedicated technological solution, to be determined by the Authorities.
- 3.2.5 It is hereby proposed that the frequency of regulatory reporting requirements will be on a daily basis, subject to the applicability of the relevant thresholds (including the minimum transfer amount of all margin transfers noted in paragraph 3(3) of the Joint Standard) to exchange initial and variation margin stipulated within the Joint Standard. In addition, regulatory reporting requirements will apply to all domestic systemically important banks, regardless of the applicability of thresholds and the minimum transfer amount noted in paragraph 3(3) of the Joint Standard. The technological requirements will be determined by the Authorities in due course.
- 3.2.6 Table 1 below provides the regulatory metrics (and field data types) to be submitted. The data will be submitted at a counterparty netting set level, which netting set will be determined through the applicable legal agreement. The data submitted will also adhere to the applicable minimum transfer amount, as prescribed in the Joint Standard. The field data types specified are commonly used in software development but may differ based on applicable programming languages used. The Authorities will provide sufficient clarity on these low-level details when determining the technological solution noted in paragraph 3.1.4 above.

Table 1: Proposed regulatory reporting metrics

Primary	Secondary	Field data type	Netting set 1 value	...	Netting set (n) value
Portfolio ID		String			
Counterparty name		String			
Counterparty ID (company registration number)		String			
Product class		Enumeration (credit, commodity, equity, foreign exchange, interest rate, rates and fx, other)			
Gross notional exposure (R'000)		Double (with two decimal points)			
Calculated initial margin for the reporting institution(R'000)		Double (with two decimal points)			
Calculated initial margin for the counterparty(R'000)		Double (with two decimal points)			
Calculated variation margin(R'000)		Double (with two decimal points)			
Collateral posted - initial margin		String concatenation with comma delimitation (Currency, Asset, Instrument) e.g; ZAR, Cash, N/A or ZAR, Bond, R186			
	Type (ZAR cash, non-ZAR cash, Gold, etc.)	ZAR, Bond, R186			
	Amount (R'000)	Double (with two decimal points)			
	Applicable haircut (%)	Double (with two decimal points)			
Collateral received - initial margin		String concatenation with comma delimitation (Currency, Asset, Instrument)			
	Type (ZAR cash, non-ZAR cash, Gold, etc.)				
	Amount (R'000)	Double (with two decimal points)			
	Applicable haircut (%)	Double (with two decimal points)			
Collateral posted/received - variation margin		String concatenation with comma delimitation (Currency, Asset, Instrument)			
	Type (ZAR cash, non-ZAR cash, Gold, etc.)				
	Amount (R'000)	Double (with two decimal points)			
	Applicable haircut (%)	Double (with two decimal points)			

4. Invitation for comment and next steps

4.1 All interested persons are hereby invited to submit comments on the abovementioned proposals as set out in paragraphs 3.1 and 3.2 above by using the comment templates attached as follows:

- Annexure A - to be utilised for comments on paragraph 3.1: Proposal to expand eligible collateral; and
- Annexure B - to be utilised for comments on paragraph 3.2: Regulatory reporting requirements for margin requirements

4.2 Comments must be submitted to the Authorities via email at queries.otc@fsc.co.za and marginrequirements@resbank.co.za by no later than **13 October 2022**.

4.3 For further information related to this discussion document and the proposals herein, please contact the Authorities via the above-mentioned emails.