

Ref.: 15/10/2

**Statement of the need for, expected impact and intended operation of a regulatory instrument\***

**Amendments to Joint Standard 2 of 2020 – Margin Requirements for non-centrally cleared over-the-counter derivatives margin transactions**

**April 2023**

\*This statement is prepared and published in accordance with and in fulfilment of the requirements under section 98(1) of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017)

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## 1. Introduction

- 1.1. In terms of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act), a regulatory instrument (i.e. a prudential, conduct or joint standard) must not be made unless the maker, in this case, the Prudential Authority (PA) and Financial Sector Conduct Authority (FSCA) (the Authorities), has published:
  - (a) a draft of the regulatory instrument;
  - (b) a statement explaining the need for and the intended operation of the regulatory instrument;
  - (c) a notice inviting submissions in relation to the regulatory instrument and stating where, how and by when submissions are to be made; and
  - (d) a statement of the expected impact of the regulatory instrument.
- 1.2. The above requirements also apply to an instrument amending or revoking another instrument as specified under the definition of a ‘regulatory instrument’.
- 1.3. In line with the requirements under the FSR Act, the Authorities have prepared a statement of the need for, expected impact and intended operation (Statement) for the proposed amendments to Joint Standard 2 of 2020<sup>1</sup> on margin requirements for non-centrally cleared over-the-counter (OTC) derivative transactions (Joint Standard).
- 1.4. This Statement covers the need for the amendments, the expected impact of implementing the revised Joint Standard as well as the intended operation of the amendments to the Joint Standard.

## 2. Background

- 2.1. In 2011 the Basel Committee on Banking Supervision (BCBS) and the International Organisation for Securities Commissions (IOSCO) were mandated by the Group of Twenty (G20) to develop standards on margining for non-centrally cleared OTC derivatives to offer enhanced protection against counterparty credit risk. Consequently, South Africa focussed on the development of a standard for the margin requirements and the Authorities considered it appropriate for the margin requirements to be issued as a joint standard under the FSR Act. In June 2020, the Authorities published Joint Standard 2 of 2020 relating to the margin requirements for non-centrally cleared OTC derivatives transactions. This was after a robust public consultation process, that also

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<sup>1</sup> Available at: [FSCA website](#) and [PA webpage](#)

included the tabling of the Joint Standard before Parliament for 30 days. The final version of the Joint Standard came into effect on 16 August 2021 in terms of a determination published by the Authorities under Joint Notice 1 of 2021 on 9 June 2021, alongside Joint Communication 2 of 2021<sup>2</sup>.

2.2. The Authorities also published Joint Communication 4 of 2021 on 16 August 2021, which was accompanied by an implementation roadmap and a request for information with inputs due to the Authorities by 1 December 2021. The so-called implementation suite was aimed at assisting the industry in operationalising the requirements of the Joint Standard and was accompanied by two application forms related to the implementation of the Joint Standard<sup>3</sup>.

2.3. Furthermore, the Authorities also issued a Joint Notice 1 of 2022<sup>4</sup>, to extend the phase-in periods referred to in paragraphs 4.2(3) and 5(3)(b) of Joint Standard 2 of 2020.

### **3. Statement of need – context and definition of the policy problem**

3.1. The proposed amendments to the Joint Standard are broadly aimed at addressing two shortcomings in the Joint Standard as well as effect minor refinements for clarity and drafting changes to align the terminology in the Joint Standard to that of the FSR Act.

#### *Enabling regulatory reporting*

3.2. As part of the preparatory process to implement the Joint Standard, the Authorities have had targeted engagements with the industry and representative bodies, in line with the Authorities undertaking to continuously engage the industry and provide the necessary guidance on the implementation of the Joint Standard.

3.3. The implementation roadmap published as part of the implementation suite referred to in paragraph 2.4 alluded to the development of regulatory reporting requirements through a phased-in approach. The aim is to implement the ongoing submission of specific information pertaining to transactions between a provider<sup>5</sup> and a counterparty to the PA. It is envisaged that the providers and counterparties will be required to ultimately submit such information to the PA in the form and manner determined by the Authorities.

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<sup>2</sup> Available at: [FSCA website](#) and [PA webpage](#)

<sup>3</sup> Available at: [FSCA website](#) and [PA webpage](#)

<sup>4</sup> Notice available by clicking on the following link: [Joint Notice 1 of 2022](#)

<sup>5</sup> An authorised OTC derivative provider as defined in the FMA Regulations.

- 3.4. The implementation of this proposal is envisaged to involve two phases consisting of:
- (i) an interim requirement in terms of which providers and counterparties will be required to submit information/data on a predetermined Microsoft Excel template pending; and
  - (ii) the development of a dedicated technological solution by the PA in terms of which the reporting will be done.
- 3.5. The FSCA supports the need for the PA to obtain this information to aid in the effective supervision and enforcement of the Joint Standard in line with the objectives of the Authorities.
- 3.6. The Joint Standard, in its current form, does not include general reporting requirements relating to providers entering into non-centrally cleared OTC derivative transactions with a counterparty or foreign counterparty or counterparty that is a financial institution. It merely provides for very limited reporting specified in the Joint Standard. These specific reporting requirements do not contemplate reporting on a continuous basis, but rather refer to the reporting that is necessary as and when a particular requirement of the Joint Standard is met<sup>6</sup>.
- 3.7. In terms of the respective mandates of the Authorities, there is an oversight obligation on the Authorities to monitor and supervise compliance by the providers and counterparties (both defined in the Joint Standard) with the requirements in the Joint Standard. In addition, for the Authorities to have the required level of supervisory oversight and the requisite information on the counterparty profiles and efficiency of counterparties in computing required margins, the Authorities need to have access to accurate, up-to-date and detailed information on the non-centrally cleared OTC derivative transactions and of the initial margin and variation margins posted.
- 3.8. The proposed amendments to the Joint Standard are intended to provide the PA and the FSCA, acting jointly or independently, with the power to determine additional reporting requirements as may be necessary. The proposed insertion of paragraph 6A will enable the Authorities to impose reporting requirements on a provider entering into an OTC derivative transaction with a counterparty or a foreign counterparty, and on a

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<sup>6</sup> In terms of paragraph 4.3(1)(i)(iv) of the Joint Standard, cash or non-cash collateral collected as initial margin may be rehypothecated, re-pledged, or re-used only once by the initial margin collector, subject to, amongst other conditions, that the margin collector must have processes and procedures to report the level and volume of rehypothecated collateral to the Authorities, as and when required.

counterparty that is a financial institution, to report specified information related to the requirements in the Joint Standard to the Authorities. 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.

- 3.9. The regulatory reporting received will enable the Authorities to have a holistic view of the market and OTC derivative transactions as well as to monitor whether the providers entering into these OTC derivative transactions are complying with the requirements to exchange margin as stipulated in the Joint Standard.

*Enabling the imposition of appropriate risk mitigation requirements by providers wanting to make use of non-cash collateral*

- 3.10. Paragraph 6(2) of the Joint Standard is already enabling in its construct, by providing for the Authorities to specify assets or instruments that may constitute eligible collateral for purposes of satisfying initial and variation margin requirements<sup>7</sup>. However, in its current form, the Joint Standard does not enable the Authorities to determine or impose conditions on risk management, internal control and assurance requirements related to the use of non-cash collateral.

- 3.11. Accordingly, it is proposed that paragraph 6 of the Joint Standard be expanded by inserting a new paragraph 6(2A), in order to enable the Authorities to determine conditions for the use of specified collateral.

*Drafting refinements to the quantitative portfolio margin models*

- 3.12. The Authorities also propose to amend sub-paragraph 4.6(b) to clarify the requirements on the identified period of historical data utilised for calibration purposes when a quantitative portfolio margin model is selected to compute the initial margin. The existing sub-paragraph 4.6(b) of the Joint Standard state that:

*... “A provider that wishes to adopt the quantitative portfolio margin model approach for the calculation of the relevant required amount of initial margin related to the potential future exposure of all relevant OTC derivative instruments, must-*

*...*

- (b) implement and maintain a sufficiently robust quantitative portfolio margin model, which model may either be developed internally or sourced from relevant counterparties or third-party vendors, that calculates an extreme but plausible estimate of an increase in the value of the instrument that is consistent with a one-*

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<sup>7</sup> Work is underway to determine the mechanics of the requirements for eligible collateral.

*tailed 99% confidence interval over a 10-day horizon, based on historical data that incorporates a period of significant financial stress, provided that –*

...

(iv) *the period of significant financial stress must –*

...

*(bb) cover a historical period of not more than five years, provided that for calibration purposes, any relevant data within the period of financial stress must be equally weighted;”*

3.13. The current wording of sub-paragraph 4.6(b)(iv)(bb) implies that the requirements on the historical data utilised for calibration (i.e. the maximum period of five years and equally weighting of the data,) are only applicable to the data representing the period of significant financial stress. However, these requirements are meant to be applicable to the entire identified period of historical data to be utilised for calibration purposes on the quantitative portfolio margin model.

3.14. Accordingly, the Authorities propose that the wording in sub-paragraph 4.6(b) be amended to reflect that the requirements on the historical data utilised for calibration purposes are applicable to the entire identified period of the historical data.

3.15. Additionally, the proposed wording is also aligned to section 3.1 of the BCBS-IOSCO framework on margin requirements for non-centrally derivatives<sup>8</sup>.

#### *Refinements and alignment on the phasing-in of initial margin requirements*

3.16. The Authorities propose additional wording in paragraph 4.2 to clarify that the calculation of the aggregate month-end average notional amount must be calculated at a group level for both the provider and the counterparty. The minor insertions in paragraph 4.2 are aimed at providing clarity in this regard.

3.17. The phase-in dates as set out in subparagraphs 4.2(4), 4.2(5) and 4.2(6) are proposed to be amended to allow for an additional year to give effect to the phasing in of the initial margin requirements. As explained in paragraph 2.5 above, the Authorities already extended the phase-in periods referred to in paragraphs 4.2(3) and 5(3)(b) of the Joint Standard by one year through Joint Notice 1 of 2022. To align to these extended periods for compliance, it is proposed that the forthcoming dates in subparagraphs 4.2(4),

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<sup>8</sup> [Margin requirements for non-centrally cleared derivatives \(bis.org\)](https://www.bis.org)

4.2(5) and 4.2(6) be amended prospectively to shift the dates by 1 year to align with the Joint Notice 1 of 2022.

*Aligning the terminology in the Joint Standard to that of the FSR Act*

- 3.18. Sub-paragraph 6(2) will also be further refined to align the terminology used to that of the FSR Act. Section 108(2) of the FSR Act prescribes that a standard may provide for a financial sector regulator or the Reserve Bank to make determinations, in accordance with procedures defined in a standard, for the purposes of the standard. A distinction can be made between the use of the word “prescribe” (which means in a regulatory instrument such as a standard) and “determination” (or determined) as is meant by section 108(2) of the FSR Act. The latter is usually done by notice published on the websites of the Authorities. To ensure consistency and certainty in the interpretation of the Joint Standard, it is therefore proposed to amend the terminology to ensure alignment with the FSR Act and other standards.
- 3.19. Likewise, and for the same reason, paragraph (h) of the definition of “counterparty” will be amended to replace the reference to “as may be declared” to “as may be determined”.

**4. Expected impact of the proposed amendments to the Joint Standard**

- 4.1. It is expected that the proposed changes to the terminology in paragraph (h) of the definition of “counterparty” and paragraph 6(2) will aid in the consistent interpretation of the Joint Standard, in line with the FSR Act, and aid in legal certainty, and that this will not have any negative impact on the industry.
- 4.2. The insertion of paragraph 6(2A) to enable the Authorities to impose the necessary risk mitigation requirements when expanding eligible collateral is also not expected to have any material negative impact on the industry. The imposition of relevant conditions proportionate to the risks that may arise when providers opt to make use of non-cash collateral is considered appropriate and sufficiently flexible to enable proactive mitigation of the risks related to the use of non-cash collateral. Ultimately this is expected to have a positive impact on the industry by ensuring the safety and soundness of these providers and enhancing and supporting the efficiency and integrity of financial markets while protecting the interest of financial customers.

- 4.3. It is expected that complying with the reporting requirements, introduced through the amendment to the Joint Standard, (once the reporting format etc is determined by the Authorities) will result in an additional administrative burden on providers and counterparties<sup>9</sup> (where applicable), which may have cost implications on the processes, systems, and human resources of these providers and counterparties. That said, the direct impact on the cost is expected to be minimal and justified in order to ensure that the Authorities have access to accurate, up-to-date and detailed information on non-centrally cleared OTC derivative transactions entered into by a provider with a counterparty or foreign counterparty.
- 4.4. While there may be additional administrative costs, it must also be noted that the regulatory reporting requirements will apply to providers subject to the minimum transfer amount noted in paragraph 3(3) of the Joint Standard and as contemplated in the relevant thresholds for exchanging margin, as specified in paragraph 5(3) of the Joint Standard. The impact will therefore be limited and only apply to providers that exchange margin above the threshold. Accordingly, only necessary and relevant information based on the envisaged risk will need to be reported.
- 4.5. The amendments to the Joint Standard are intended to improve transparency and enhance regulatory oversight as information will be analysed and monitored to enable a better assessment of the risks associated with the implementation of the margin requirements placed on providers of non-centrally cleared OTC derivative transactions.

## **5. Statement of intended operation**

- 5.1. The amendments to the Joint Standard are consistent with the objective of the FSR Act, and specifically the mandates of the Authorities to maintain a stable financial system that functions in the interests of financial customers and supports balanced and sustainable economic growth.
- 5.2. The amendments, once effective, will enable the Authorities to, when expanding eligible collateral in line with paragraph 6(2), set conditions for the use of such collateral. These conditions will be part of the determination by notice, which will be published by the Authorities and available to the public on the respective websites.

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<sup>9</sup> Reporting requirements may be imposed on providers, and on financial institutions that are counterparties.



- 5.3. The reporting requirements will apply to a provider that enters into a non-centrally cleared OTC derivative transaction with a counterparty or a foreign counterparty, and a financial institution that is a counterparty that falls within the relevant thresholds for exchanging margin as specified in the Joint Standard.
- 5.4. The Authorities may determine the form, manner, content and period of such reporting by notice on their respective websites and the reporting templates may be updated from time to time in line with the regulatory need and changes in the market and related risks.
- 5.5. The amendments to the Joint Standard are envisaged to commence after the consultation process prescribed in the FSR Act has been concluded.
- 5.6. Following the implementation of the amendments to the Joint Standard, the Authorities will assess and evaluate the effect of the amendments continuously as part of their supervisory responsibility to mitigate any unintended consequences of these amendments should these arise.

## **6. Contact**

- 6.1. For more information regarding the amendments to the Joint Standard please contact the Authorities via email as follows:
  - FSCA's Regulatory Framework Department at: [FSCA.RFDStandards@fsca.co.za](mailto:FSCA.RFDStandards@fsca.co.za) and
  - PA's Policy Department at: [PA-Standards@resbank.co.za](mailto:PA-Standards@resbank.co.za).