Margin Requirements for Non-Centrally Cleared Derivatives

Board Notice Comments and Response Matrix

31 July 2017

Commentators

1. IG Markets South Africa Limited
2. Standard Bank
3. JSE limited
4. Macquarie Securities
5. Purple Group
6. BASA
7. Barclays Group
8. Peregrine
9. ACTSA/SABMiller
<table>
<thead>
<tr>
<th>COMMENTATOR</th>
<th>SECTION</th>
<th>COMMENTS</th>
<th>RESPONSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>IG Markets</td>
<td>Framework</td>
<td>We consider that there are areas, where the draft regulations materially differ from other countries that have adopted regulations to adhere to these G20 obligations in relation to the scope of these regulations and in relation to the application of the initial margin rules and the when they are introduced from. Considering the draft margin requirements for non-centrally cleared OTC derivative transactions:</td>
<td>Thank you for the comments and the support, indeed it is of utmost importance to develop frameworks that are consistent and aligned in order to minimise disruptions while supporting the objectives of the Financial Markets Act and meet the G20 obligations for OTC derivatives market reforms.</td>
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<tr>
<td></td>
<td>Alignment</td>
<td>• We support increased regulation to limit excessive and opaque risk-taking through OTC derivatives by large systemic OTC derivatives traders.</td>
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<td></td>
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<td>• We support regulation to reduce the systemic risk posed by large systemic OTC derivatives traders.</td>
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<td>We thoroughly support the efforts to ensure consistency in regulation across various jurisdictions so as to reduce the opportunity for regulatory arbitrage.</td>
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<td>Peregrine Framework Alignment</td>
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<td>We have found the principles outlined in the National Treasury Policy Statement on OTC derivatives comprehensive, balanced and in line with international best practice.</td>
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In general, the Regulations translate these principles into a workable framework for registration, market conduct and reporting obligations.

However, we have found that the draft initial margin requirements contained in the Notice deviate significantly from principles set forth in the international guidelines contained in the document entitled “Margin requirements for non-centrally cleared derivatives” developed by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions (the “BCBS-IOSCO Framework”).

The requirement that ALL entities (banks, as well as other financial and non-financial entities) must post and receive initial margin is in direct contrast to the international guidelines. The proposed requirement will have a devastating impact on the delivery of essential financial products, will drive users of these products to other jurisdictions and will negatively impact employment and the tax revenue generated by South Africa’s sophisticated financial services sector. We propose that clients (as defined in the Regulations) are exempted from the initial margin.

The comments are noted. The revised Notice seeks to align as closely as possible to the BCBS-IOSCO recommendations but also reflects the unique domestic framework.

A definition for “covered entities” has been included, which includes authorised OTC derivative providers and specified counterparties.

Under the revised requirements, re-hypothecation is allowed subject to the specified requirements and conditions - please see paragraph 4.3.

The phasing in of the requirements is further provided for in paragraph 4.2.

Please refer to the revised Notice.
margin requirement and that other thresholds be set to bring the initial margin requirement in line with international guidelines.

The absolute prohibition on the re-hypothecation of collateral contained in the Notice will have a severe dampening effect on the market's ability to effectively raise capital and hedge risks, and will further diminish liquidity in South African financial markets. The BCBS-IOSCO Framework allows providers to re-hypothecate collateral under controlled conditions. We support the limiting provisions and controlled arrangements under which the BCBS-IOSCO Framework suggests that re-hypothecation of collateral should be allowed. However, a prohibition on all re-hypothecation will severely constrain South-Africa's financial markets and prevent effective capital formation. The emerging nature of our economy demands innovation, flexibility and efficiency – within a prudential framework.

Finally, the requirements of the Notice should be phased in on a basis similar to that suggested in Key principle 8 of the BCBS-IOSCO Framework in order to minimise market disruption.

<table>
<thead>
<tr>
<th>BASA</th>
<th>Framework Alignment</th>
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<tr>
<td></td>
<td>We do not believe that the margin provisions as they currently stand are aligned with the margin principles for non-cleared transactions that is currently being considered offshore. We propose that the FMA regulations be aligned</td>
</tr>
</tbody>
</table>

We note your comments on the margin requirements framework. Amendments have been made to
as much as possible with other offshore frameworks and the principles published (where relevant) by IOSCO to ensure that harmonisation with the rules of offshore regulatory frameworks can be achieved.

EU and US regulators are in the process of putting in place the margin requirements that apply to non-cleared OTC derivatives, and are broadly subscribing to the principles introduced in the BCBS / IOSCO principles published in March 2015. In particular, offshore regulators are subscribing to the BCBS / IOSCO principles with regards to the scope of entities (“covered entities”) that should be caught in the framework for bilateral exchange of variation margin and initial margin (respectively), and also with regards to thresholds and timelines of impact.

All financial institutions in South Africa who are engaging in trading activities with counterparts in the EU and US will be caught by the frameworks for margining of non-cleared OTC derivatives that are being put in place there. To avoid regulatory arbitrage, it is imperative that South Africa does not exaggerate the margin thresholds or impact timelines to such extent that it would discourage the local and /or international community from transacting non-cleared OTC derivatives with local market participants (in particular, the local banks).

The current proposed margining regulations are written in a very different format to the BCBS/IOSCO policy the contents of the Notice. The intention of the margin requirements is to align as close as possible to the BCBS-IOSCO framework, but at the same time having regard to the domestic context.

The new thresholds proposed will leave most entities out of the ambit of the requirements for margin as they are more closely aligned to the thresholds in the BCBS-IOSCO framework.

Thresholds are not determined by counterparty type, but apply across board on the defined “covered entities” — please see the revised Notice.

The margin requirements will be phased-in, similar to the approach in the BCBS-IOSCO recommendations although the implementation date adopted in
framework. This difference adds an administrative burden to local and international entities as they will have to deal with materially differently worded regulations aiming to achieve the same end.

The recommendation would be to align the Regulations and in particular the Board Notice to the BCBS/IOSCO policy framework in respect of –

1. Margin thresholds, introduced on a phased in timeline;
2. Definition of entities covered that are subject to the margining provisions, i.e. **covered entities** and the scope of applicability;
3. Calculation of margin thresholds;
4. Scope of coverage – instruments subject to the requirements;
5. Introduction of a minimum transfer amount, and initial margin threshold;
6. Introduction of an intra-group exemption;
7. Types of eligible collateral;
8. Clarification on whether state owned entities are in / out of scope.

This is based on the following:

- South Africa appears to have relatively greater difficulty with achieving compliance with the liquidity requirements SA will differ.

It is not the intention of the margin requirements to be more stringent for the domestic counterparts. However, the BCBS-IOSCO framework has been adapted where necessary for the domestic context.

A definition of covered entities has been included, it includes ODPs and specified counterparties, therefore state owned entities or any person not listed as a covered entity is not scoped-in the margin framework. In addition, the Registrar of Securities Services may determine other persons who must comply with the margin requirements.

*Please see the revised Notice.*
stemming from LCR (possibly NSFR too), partially because the international regulations don’t recognize the benefits caused by the partially closed nature of the economy. This implies that South Africa is in an even more constrained position than many other regions, suggesting that we need to be as careful as possible about adding more pressure to this space through the margining regulations.

- Required margin (both VM and IM) in a closed economy like South Africa, especially with its relatively small corporate debt market, would have to be sourced, in the majority, from the banks. This would defeat the point of margining requirements as there would be little net reduction in systemic risk to the SA banking system.

- South Africa has relatively few liquid assets eligible for margin purposes (as evidenced by the LCR issue above). This is exacerbated by regulations requiring segregation and preventing re-hypothecation as this rule’s out the use of cash for IM purposes and further reduce liquidity of the assets used.

- Most South African corporates trade derivatives for cash flow certainty. The only corporates that can deal with uncertainty are those with large, fully staffed treasuries and easy access to worldwide corporate bond and commercial paper markets. Thresholds that pick up corporates below this level of critical mass will cause major problems for those corporates. The proposed
regulations seem to force VM for every entity trading with a bank, along with IM for nearly all entities.
- The re-papering required at the international thresholds will be a monumental undertaking. At the currently proposed South African thresholds, this would be a near impossibility.
- Bespoke derivatives (those not clearable) are often entered into in order to gain hedge effectiveness for the client. This could be ruined by VM requirements, adding unnecessary volatility to corporate income statements

The non-alignment with the BCBS/IOSCO framework creates an un-level playing field for South African market participants competing with international participants, who are subject to higher thresholds, and this will ultimately have a negative impact on the wider South African economy.

| Barclays | Framework Alignment | The Second Draft Policy Document, in respect of margin requirements provides -

"The proposed collateralisation is consistent with international standards as presented in the final 2013 BCBS — IOSCO paper; this will ensure the control of international arbitrage by creating a level playing field for all providers in the OTC market."

and

The comments are noted. Some amendments have been incorporated, taking into account the BCBS-IOSCO recommendations.

*Please refer to the revised Notice.*
“The phase-in time lines are aligned to the proposed BCBS—IOSCO timelines, to ensure that South Africa does not prejudice those OTC derivatives providers with exposures to counterparties in other jurisdictions that must comply with the relevant margin requirements.”

Whilst we fully support the alignment with BCBS-IOSCO principles, factually these statements are incorrect, as the provisions in the proposed Board Notice are neither aligned nor consistent with BCBS-IOSCO principles, since the Board Notice:

- is not clear regarding the obligation on both providers and counterparties to exchange initial margin: “provide on a bilateral basis” does not mean that both parties are required to exchange margin (universal two-way margin). This potential interpretation issue is exacerbated by the language in paragraph 9, where only providers are referred to in exclusion thresholds;

- does not align with the BCBS-IOSCO initial margin thresholds and the de-minimis minimum transfer amount;

- does not allow re—hypotheecation. re-pledging and re-use of collateral. without due regard to the liquidity
impact in the South African market;

- does not provide for the eligibility of collateral (e.g. in respect of liquidity and wrong—way risk);
- does not provide for the treatment transactions with affiliates;
- does not provide for consistency in the treatment of cross-border transactions; and
- does not provide phase-in timelines aligned with the BCBS-IOSCO timelines, provided for in the BCBS-IOSCO March 2015 framework (BCBS-IOSCO framework).

We strongly recommend that the South African approach to margin for non-centrally cleared OTC derivatives is fully aligned to the BCBS-IOSCO framework.

### Scope of application

<table>
<thead>
<tr>
<th>Peregrine</th>
<th>Exclusion of Clients</th>
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<tr>
<td>1. The requirement that ALL entities (banks, as well as other financial and non-financial entities) must post and receive initial margin is in direct contrast to the international guidelines. The proposed requirement will have a devastating impact on the delivery of essential financial products, will drive users of these products to other jurisdictions and will negatively impact the South African market;</td>
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</table>

The margin requirements do not apply to all entities, only the ODPs defined in the FMA regulations and the counterparties specified in the revised Notice.
impact employment and the tax revenue generated by South Africa’s sophisticated financial services sector. We propose that clients (as defined in the Regulations) are exempted from the initial margin requirement and that other thresholds be set to bring the initial margin requirement in line with international guidelines.

2. “counterparty” and “client” means “counterparty” and “client”, respectively, as defined in the Regulations. Includes a client as defined in the Regulations;

By including clients in the concept of counterparty for purposes of the Notice, private clients and corporates with no means to hold initial margin are drawn into the requirement to exchange initial margin. Clients should be excluded.

This is in line with the requirements of Key principal 2 of the BCBS-IOSCO Framework (page 10, paragraph 2.6) which states:

“Only non-centrally cleared derivatives transactions between two covered entities are governed by the requirements in this paper.”

(Covered entities are define in 2.4 of the BCBS-IOSCO Framework as “financial firms and systemically important non-financial entities”.)

Please see the revised Notice.
3. Suggestion: “clients” should be excluded from “counterparties” under the Notice

The Notice’s definition of “Counterparty” in paragraph 1 specifically includes “clients” (as defined in the Regulations). This has the effect of including private individuals, non-financial entities and other non-systematically important entities in the category of persons required to post and receive initial margin.

We view the inclusion of “clients” in this requirement as inconsistent with the achievement of Objective 1 of the Policy Statement: “Contributing to the maintenance of a stable financial market environment and reducing systemic risk”. It is also in conflict with Principle 1 of the same policy: “Adoption of appropriate international standards”

Clients post little if any systemic risk. Burdening these users of financial products with the operational legal and capital requirement to process bilateral margin serves no purpose in fulfilling the stated objectives or following the stated principles of the Policy Statement.

Further, the margining requirement will have a meaningful impact on
- Market liquidity, as many OTC derivative financial products sold to retail clients will disappear. All financial products with any derivative component will
be affected.
  - Cost of capital, as clients will be required to revert back to non-derivative products to achieve similar outcomes but at a higher cost.
  - Market efficiency, as a narrowing of the product range available to clients will create product monopolies executed at a higher cost.
  - Operational requirements for non-financial entities, as receiving margin and keeping it separated from proprietary assets cannot be done by clients.
  - Innovation in financial markets, as OTC derivatives are currently at the forefront of innovation and flexibility.

Additionally many reputable and experienced OTC service providers in both the banking and non-banking sectors will be forced to discontinue their activity and products. Some activity may migrate to centrally cleared venues if they become available, the bulk will discontinue completely or migrate to other jurisdictions.
| Covered Entity definition | The recommendation would be to align the Regulations and in particular the Board Notice to the BCBS/IOSCO policy framework in respect of –

Definition of entities covered that are subject to the margining provisions, i.e. covered entities and the scope of applicability.

“counterparty” includes a client as defined in the Regulations

We do not understand this definition and why it is not consistent with the definition in the Regulations. It is submitted that for consistency and the avoidance of confusion that the definitions are the same as in the Regulations. In addition, we are of the view that the margining requirement should not apply to clients.

We propose that in aligning the Board Notice and the Regulations to the BCBS/IOSCO policy framework, that a definition of Covered Entities is inserted and propose the following:

- “covered entity” includes a provider and a systemically important counterparty

- “systemically important counterparty” includes a counterparty as defined in the Regulations which has an OTC derivative exposure which exceeds a pre-

The amendments exclude clients from the margin framework.

Noted. Covered entity includes ODPs as defined in the FMA regulations and counterparties as specified under the revised Notice.

We disagree with the suggestion to capture only the systemically important counterparties. The revised requirements are intended to capture those institutions that engage in OTC derivative transactions above certain thresholds as prescribed in the revised Notice. Given the current provisions in the regulatory framework, it would require processes to make determinations/designation for systemically important financial and non-financial entities by the Authorities. Using this approach, will further exclude participants in OTC derivative transactions from...
determined classification threshold

- In line with the recommended definition changes, the word covered entity should replace provider and counterparty throughout the Board Notice.

Please see the revised Notice.

| IG Markets | Exclusion of Clients | We note that the draft margin regulations appear to treat retail clients, natural people and non-systemic juristic people (people who are not financial market participants), as “counterparties”. There is no express exclusion for these people from the potential obligation to provide bilateral initial margin. We would request that the National Treasury gives detailed consideration to expressly exempting this group of clients from any mandatory initial margin requirements. |
| See the revised Notice – reference to clients has been removed from the margin requirements. The margin requirements only extend to authorised ODPs as defined in the FMA Regulations and specified counterparties in the revised |
This request is based on the following considerations:

- Retail clients, natural people and non-systemic juristic people trade in small sizes and the overall exposure to the market is not of systemic importance.
- To require these clients to provide initial margin on a bilateral basis would result in the majority of these clients being unable to trade due to not having the facility to accept and segregate collateral.
- Excluding these clients from the margin requirement regulations by no means excludes clients or their providers from requirements of other published draft regulations.

To exempt retail clients, natural people and non-systemic juristic people from these obligations is consistent with the developments in other G20 countries and in particular the EU with the reference to non-financial counterparties below the threshold (NFC) and the express exclusion of natural people from the obligations set out in EMIR in the EU.

<table>
<thead>
<tr>
<th>Barclays</th>
<th>Exclusion of Clients</th>
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<tbody>
<tr>
<td>We recommend that the requirements in respect of margin for non-centrally cleared OTC derivatives are only applicable to ODPs and systemically important counterparties (i.e. covered entities). Clients and non-systemically important counterparties do not have the necessary infrastructure to</td>
<td>The comments are noted, and reference to clients has been removed, please see the revised Notice. Regarding systemically important institutions, please refer</td>
</tr>
<tr>
<td>Macquarie Securities (Round 2)</td>
<td>Exclusion of Clients</td>
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</tbody>
</table>
| Purple group | Exclusion of Clients | The FMA Margin Requirements Regulations, in respect of margin requirements should only apply where derivative transactions are entered into between two systemically important entities.  

As such:

- Clients (non-financial firms that are not systemically important) should be excluded from the definition of covered entities; |

The comments with respect to clients are noted – please see the revised Notice. The margin requirements are, however, not limited to systemically important entities.  

Agreed. Margins apply if transactions are between covered entities that are ODPs, defined in... |
- The regulations should be clear that, only, OTC derivative transactions between two covered entities are covered by the FMA Margin Requirements Regulations in respect of Margin requirements. I.e. where one party to the transaction is a “covered entity” and the other party is not, then the FMA Margin Requirements Regulations in respect of Margin Requirements will not apply between those parties.

<table>
<thead>
<tr>
<th>ACTSA/SABMiller</th>
<th>Exclusion of Clients</th>
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<tr>
<td>“counterparty” includes a and “client” have the same meanings as defined in the Regulations; and Counterparties and clients should be treated differently for margining purposes.</td>
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<tr>
<td>Clients, including corporates, will generally not have the necessary infrastructure to mark their transactions to margin or to receive margin.</td>
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</table>

Please refer to the response above.

<table>
<thead>
<tr>
<th>BASA</th>
<th>Netting Set</th>
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<tr>
<td>We propose the following words used in section 6 of the Notice are added as definitions to avoid inconsistency and confusion: “netting set”</td>
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</table>

“Netting set” has been defined. Please see the revised Notice.
<table>
<thead>
<tr>
<th>Peregrine</th>
<th>Netting Set</th>
<th>Insert: “netting set” means all derivatives covered by an enforceable bilateral netting agreement; The term “netting set” is used throughout the Notice without a definition.</th>
<th>“Netting set” has been defined. Please see the revised Notice.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BASA</td>
<td>Group Consolidated</td>
<td>“group consolidated” – clarity is required as to whether this refers only to a group with a holding company in the Republic or whether it means a group irrespective of the jurisdiction of the holding company, its subsidiaries, affiliates and branches.</td>
<td>Please see the revised Notice. “Group” has the same meaning as in the Companies Act.</td>
</tr>
<tr>
<td>Macquarie Securities (Round 2)</td>
<td>Non-centrally OTC derivative transactions</td>
<td>We propose that the “non-centrally cleared OTC derivative transactions” should also be specified by the registrar (as with “cleared” transactions) in detail – ISDA transaction types may serve as a means of categorisation. We further propose that the definition “non-centrally cleared OTC derivative transactions” be limited to “...an OTC derivative [specified by the registrar] that is executed, whether confirmed or not confirmed, pursuant to a “master agreement” as defined in section 35B(2) of the Insolvency Act, 1936 which has not otherwise been designated as an OTC derivative that is required to be cleared through a central counterparty by the registrar”.</td>
<td>Disagree. It is not necessary to specify the non-centrally cleared derivative transactions for the purpose of margin requirements. Exclusions are provided for the following: Physically settled foreign exchange forwards and swaps are excluded from initial margin requirements. Securities lending and repurchase agreement with similar attributes as derivatives are not captured by the definition of OTC derivatives. Please see the revised Notice.</td>
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## Risk Management Framework

### BASA/IG Markets

**Intragroup Transactions Paragraph 3(2)(f)**

In line with the BCBS / IOSCO principles, we propose that intra-group transactions be excluded from the requirement to post IM and VM under the margin rules for non-cleared OTC derivatives transactions.

We recommend that intragroup transactions are exempt from the requirement to exchange collateral if certain requirements on risk management procedures are met and approved by the relevant competent authorities in each jurisdiction. This is in line with international standards and the proposed regulations in EMIR.

The comment is noted. Please see the revisions to the Notice in respect of the treatment of intragroup transactions.

### Peregrine

**Paragraph 3(5)**

**Option 1:** Delete clause

**Option 2:** Substitute with *“A provider must be appropriately capitalised.”*

**Option 3:** Amend to read *“A provider must hold appropriate capital against all of the relevant risks not covered by appropriate exchange of collateral.”*

The wording “…must hold capital…” may be open for

Substantial amendments were made to the section on risk management requirements to align with the BCBS-IOSCO framework. *See the revised Notice under the heading “general requirements.”*
interpretation and may mean that the full risk should be covered by capital irrespective of the probability of such risk taking place.

The wording “…against all of the risks…” is too wide-ranging and may be interpreted to include operational, business, liquidity and other risks not intended to be included.

<table>
<thead>
<tr>
<th>Macquarie Securities (Round 2)</th>
<th>Section 3(5) Risk Management</th>
<th>A capital adequacy regime is prescribed by “Criteria for Authorisation as an OTC derivatives provider” – please delete or otherwise link Section 3(5) to the regime prescribed by the aforementioned. As it currently stands it is vague.</th>
<th>Amendments have been made to the section on the risk management requirements in the revised Notice.</th>
</tr>
</thead>
</table>

**Initial Margin**

| BASA | 4. | The requirement should be amended so that it places an obligation on **covered entities** to place and receive margin as required based on the valuation of the derivatives entered into between two **covered entities**. This is consistent with the current bilateral arrangements under the ISDA master agreement and Credit Support Annex. We propose the following amendments –  
4. **Initial Margin**  
(1) **Covered entities** must, subject to the relevant | Amendments have been made in the revised Notice to clarify the requirement to exchange initial margin. Only covered entities are required to exchange margin. |
|-------|----|--------------------------------------------------------------------------------|----------------------------------------------------------------------------------|
thresholds and exemptions in this Notice, exchange, on a bilateral basis, initial margin on all non-centrally cleared OTC derivative transactions in terms of the requirements set out in this Notice.

(2) Covered entities must exchange initial margin by no later than the business day following the execution of a non-centrally cleared OTC derivative transaction.

<table>
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<th>Purple group</th>
<th>4(1)</th>
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</table>
| Initial margin collected, outside of the requirements of these regulations, should specifically be excluded from the provisions of these regulations; hence an OTC derivatives provider that is facing clients (that are not systemically important) will be able to re-hypothecate client margin to a prime broker (for hedging purposes) and the prime broker in turn should be able to re-hypothecate the client margin again, to the extent necessary (whereas if the regulations apply, then initial margin will only be allowed to be re-hypothecated once).

The FMA Margin Requirements Regulations should be changed to allow the re-hypothecation, re-pledging or re-use of collateral held as initial margin (in respect of the requirements of this regulation), under a specific set of conditions.

The comment is noted. Please see the amendments to the revised Notice. The requirements in respect of re-hypothecation are limited to OTC derivative transactions between the covered entity/ODP that are captured in the margin framework. The initial margin collector will be allowed to re-hypothecate the counterparty’s collateral, subject to certain conditions as set out in the revised Notice, to ensure that the counterparty’s rights are protected. Re-hypothecation by the third party might introduce additional counterparty risks.
### Peregrine/ACTSA 4(1)

“A provider must, subject to the relevant thresholds and exemptions in this Notice, provide or receive on a bilateral basis...” An OTC derivative provider must also receive initial margin, i.e. the margining is bilateral.

A provider must, subject to the relevant thresholds and exemptions in this Notice, provide, on a bilateral basis, initial margin on all non-centrally cleared OTC derivative transactions concluded with counterparties in terms of the requirements set out in this Notice.

Corporates hedging is often used to achieve a measure of cash certainty. If a corporate is required to provide and receive margin, cash certainty is diminished by the need to exchange cash on a frequent and unpredictable basis.

The exclusion of corporates from the margining requirement is reflected in the BCBS IOSCO Framework in paragraph 2(c) on page 10, which states that only transactions between financial firms and systemically important non-financial entities are covered by the margin requirements in the BCBS IOSCO Framework.

Under Dodd-Frank the margin requirements do not apply to non-financial corporates hedging or mitigating commercial risk (see HL Summary page 24).

Amendments have been incorporated in the revised Notice. The notice specifies the ODPs and specific counterparties that must meet the margin requirements.

It is unclear which entities are captured by the ‘corporate’ description. Only financial institutions defined as counterparties are required to exchange margin.
<table>
<thead>
<tr>
<th>Peregrine</th>
<th>4(2)</th>
<th>“A provider must provide or receive initial margin…”. Initial margin should be bilateral.</th>
<th>Noted. Amendments have been made to the provision to reflect the suggested wording.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BASA</td>
<td>4(5)</td>
<td>The total amount of initial margin to be collected by a provider from a counterparty must be recalculated and collected at least when- (a) a new agreement is executed with that counterparty; (b) an existing agreement with that counterparty expires; (c) an existing agreement triggers a payment, other than posting or collecting variation margins, or a delivery; (d) an existing agreement is reclassified in terms of asset category by way of reduced time to maturity; It is uncertain what is meant by the word “agreement” used in this sub section. Is it supposed to refer to the derivative contract and if so is the word contract not a more universally acceptable term of use. It is submitted that the use of the word agreement can be confused with the agreements proposed under the Code of the Conduct.</td>
<td>Please see the revised Notice.</td>
</tr>
</tbody>
</table>

**Methodology for calculating Margin**
The main reason this methodology is included is because the replacement methodology will not yet have come into practise by the first stage of the BCBS/IOSCO paper. However, the standardised method proposed is widely recognised as having very material limitations, especially in the case of netted and margined sets of trades.

As such, under the assumption that no South African entities should need to place or receive IM before the application of the new standardised model, it is proposed that the new standardised model (outlined in “new standardised approach for measuring counterparty credit risk”, 31 March 2014) be used, with Appendix A adjusted accordingly.

| BASA   | 5      | The provision requires that the OTC derivative transaction is subject to a single and legally enforceable bilateral netting agreement that requires “daily netting”.

What is meant by daily netting? The ISDA Master Agreement (which is the standard agreement covering OTC derivative transactions) does not specify a netting frequency, but has the effect that, upon the occurrence of a default, all transactions entered into under the agreement will be terminated, a close-out value determined and the values so calculated will be netted.

Comment noted. Please refer to paragraph 4.4 - a provider may either use the standardised method, or with the approval of the registrar, the quantitative portfolio margin model approach.

Agreed. The Notice has been amended and the reference to daily netting has been removed.
| Peregrine | 5(1)(b) | “....*(based on its underlying asset class) as specified in Annexure A.*”
To clarify which “add-on” factor is referred to. | Wording corrected. The “add-on” factor referred to in the previous notice related to the calculation of initial margin using a standardised method. The notional amount of the derivative contracts in the netting set shall be multiplied by the “add on factor” or percentage (%) specific to that underlying asset based on table 1 provided in the notice. |

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<th>Section 6 Model Use</th>
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</table>

| BASA | 6. Model use | Our regulatory requirements should be harmonised. The BCBS proposal is for a 99% confidence interval, as is the proposed Standardised Internal Model Method (SIMM) from ISDA. In addition, we should be careful of specifying the 25% of data from a stressed period if this is materially different (above or below) international norms as, once again, this difference could lead to regulatory arbitrage. Similarly, the requirement for 6 monthly re-calibration could be counterproductive, creating pro-cyclical effects in a stress environment.

It is therefore recommended that an element of regulatory discretion be added to the frequency of re-calibration to | Agree to the first point on the accurate confidence interval. Confidence interval specified in the Notice adjusted to 99% and not 99.5% consistent with the BCBS-IOSCO proposal (see paragraph 4.6(b)).

Noted. Requirements revised for data representation, no reference to 25%.

Agreed. Reference to 6 months |
allow for the amelioration of potential pro-cyclicality.

### BASA

| 6(2)(1) – Confidence Intervals | 6.2 (1) For the calculation of the initial margins, the assumed variations in the value of the agreements in the netting set must be consistent with a one-tailed 99.5 per cent confidence interval over a margin period of risk of at least 10 days. In the policy framework establishing the minimum standards for margin requirements for non-centrally cleared derivatives, agreed by BCBS and IOSCO, a confidence interval of 99% is proposed. Is there a specific reason why a confidence level of 99.5% is proposed in this notice? | Agreed. Reference to confidence interval corrected. See the response above and the revised Notice. |

### Peregrine

| 6.3(8) | “…from the recalibration of the model, over an appropriate period, longer than one day Some incremental changes may be very small and one day should be sufficient. Other incremental changes may require several days. | Agreed and amended. |
| Peregrine | 6.4(2) | Add “gold” to “commodities”  
Move “currency” to its own class  
There is no objective reason to mix gold, interest rates and currency. Even though there may be a longer term correlation between interest rates and the currency, over the short term there may be meaningful decorrelation. |
| --- | --- | --- |
| Peregrine | 7(1) | “A provider most provide, on a bilateral basis, exchange”  
Variation margin is paid and received. |
| Peregrine | 7(3) | “Variation margin may be collected exchanged on a net basis.”  
Variation margin is paid and received. |

**Variation Margin**

| Peregrine | 7(1) | A provider most provide, on a bilateral basis, exchange  
Variation margin is paid and received. |
| --- | --- | --- |
| Peregrine | 7(3) | “Variation margin may be collected exchanged on a net basis.”  
Variation margin is paid and received. |

**Collateral Management**

| BASA | 8. Collateral Management | 8.1 Eligible collateral guidelines should be included.  
The recommendation is that these equate, at least, to those in the BCBS/IOSCO principles, including Cash, Corporate Government and Covered bonds, equities and Gold.  
In addition, given the relative lack of liquid assets in the South African market it is recommended that consideration |
| --- | --- | --- |

List of eligible collateral; has been updated. *Refer to paragraph 8(2) of the Notice.* Despite the recommendations by the BCBS-IOSCO, jurisdictions or regulators must make a determination on the list of eligible collateral taking into
be given to the discretion proposed in Requirement 4 of the
BCBS/IOSCO principles allowing for a wider range of
collateral.

8.1(2). Recommendation is to allow for a single stage of re-
 hypothecation as per the BCBC/IOSCO principles.

8.1.3. This requirement should only apply to IM exchanges.
In line with the BCBS / IOSCO principles, variation margin
need not be segregated

8.2. Segregation of initial margin.
Any costs associated with the segregation of initial margin
should be borne by the posting party.

The requirement for a provider to enter into an agreement
with a counterparty regarding the segregation of initial
margin and the arrangements regarding the safekeeping of
collateral is not provided for in this Board Notice.

It is recommended that the particular paragraph, in the
Code of Conduct, that deals with the requirement to enter
into an agreement is referenced in this paragraph

8.2(5). Are these opinions to be obtained on an agreement,
by agreement, basis. In which case, the cost of obtaining
such a legal opinion should be borne by the posting party.

account their domestic framework.
Agreed. One time re-
hypothecation is permitted.

Segregation provisions amended
to apply to initial margin.
Segregation of initial margin will
be by agreement that is legally
enforceable by the counterparties
involved. Please see amendments
to the revised Notice.

Disagree. The provider will bear
the cost of obtaining agreements
for the transactions/contracts it is
party to in various jurisdictions.
Consent is required in writing but
no frequency is included for the
agreement.
Obtaining these legal opinions on a transaction by transaction basis would be very costly. We are not opposed to obtaining legal opinions to verify the enforceability of collateral arrangements. However, as laws tend not to change overnight, we propose that the requirement be bi-annually (at most), and per jurisdiction (rather than per transaction).

8.3.1 (1) (a) The standard methodology is to be excluded, proposal is to refer to the methodology as set out in BCBS/IOSCO.

8.3.1 (1) We are uncertain why only “government securities” are referenced in (b), (d) and (e). The recommendation would be for these regulations to apply to all eligible collateral.

The standardised methodology has been updated in the latest Notice, reflecting the recommendations by the BCBS-IOSCO. Reference to government securities corrected – and the requirements apply to all eligible collateral.
| Peregrine | 8.1 and 8.1(2) | Insert new 8.1(1) (and renumber remainder of 8.1 accordingly):

“(1) When an entity receives collateral from another entity to fulfil its initial margin obligations the arrangement must comply with the provisions of this clause 8.”

A clear distinction should be drawn between the “initial margin” and “collateral”. Initial margin is the regulatory amount kept as a buffer against default on the variation margin.

Collateral comprises assets exchanged to manage the initial margin.

“(23) Collateral collected for initial margin may not be re-hypothecated, re-pledged or otherwise re-used unless the following criteria are met

- the counterparty agrees in writing to the re-hypothecation; and
- the collateral may only be re-hypothecated by the OTC

Amendments made to the revised Notice.
derivative provider and only for its hedging of the OTC
derivative transaction in respect of which it received the
initial margin.”

Often collateral received from a counterparty (especially in
the case of a retail provider of contracts for differences) is
used to obtain exposure with another OTC derivatives
provider or is used to effect the hedge in underlying
markets.

The regulation for CIS hedge funds (BN 52) allows for the
re-hypothecation of collateral provided by a CIS on the
condition that the CIS is aware of the arrangement.

This is in line with the requirements of Key principal 5 of the
BCBS-IOSCO Framework, page 20, paragraph 5(v)

“5(v) Cash and non-cash collateral collected as initial margin
from a customer may be re-hypothecated, re-pledged or re-
used (henceforth re-hypothecated) to a third party only for
purposes of hedging the initial margin collector’s derivatives
position arising out of transactions with customers for which
initial margin was collected and it must be subject to
conditions that protect the customer’s rights in the collateral,
to the extent permitted by applicable national law.”
| Peregrine | 8.2 | 8.2(1) **Collateral collected as initial margin must be segregated from proprietary assets on the books and records of a third party holder or custodian, or via other legally effective arrangements made by the collecting entity counterparty.**

This should not only refer to collateral collected for initial margin purposes.

To bring wording in line with remainder of 8.2. Also, “counterparty” has a defined meaning which excludes a derivative provider.

8.2(2) “The collecting **entity** counterparty must at all times provide the posting **entity** counterparty with the option to segregate its collateral from the assets of other posting **entities** counterparties ("individual segregation").”

To bring wording in line with remainder of 8.2.

Also, “counterparty” has a defined meaning which excludes a derivative provider.

8.2(3) “(3) **Initial margin Collateral** that is collected in cash must be segregated individually, unless the collecting counterparty can prove to its counterparty and to the

| Amendments made to the provisions in the revised Notice. |
registrar that legally effective arrangements are in place to segregate it from proprietary assets.”

Paragraph 8 deals with collateral and not only initial margin. Also see comment for 8.1.

8.2(4) “(a) initial margins are collateral is immediately available to the collecting entity where the posting entity counterparty defaults;”

Paragraph 8 deals with collateral and not only initial margin. Also see comment for 8.1.

To bring wording in line with remainder of 8.2. Also, “counterparty” has a defined meaning which excludes derivative provider.

<table>
<thead>
<tr>
<th>Peregrine</th>
<th>8.3.1(1)(a)</th>
<th>Even though there is reference to the standard methodology, there is no table as is made available in Appendix B of the BCBS-IOSCO Framework.</th>
<th>Agreed with the comment – the annexure has been updated.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macquarie Securities (Round)</td>
<td>Section 8</td>
<td>(1) A clear distinction should be made between collateral that is (a) transferred on an outright basis and (b) pledged (and, in some cases, delivered into the “possession” of the</td>
<td>1) There is no prescribed method of posting collateral in the revised Notice. Therefore, counterparties</td>
</tr>
</tbody>
</table>
| Macquarie Securities (Round 2) | 8.2 Segregation of initial margin | Holding “initial margin” on behalf of a counterparty would exclude it from the netting protection benefits of section 35B of the Insolvency Act, on the basis that it is not an “assets in which ownership has been transferred as collateral” can determine the methods for posting collateral as it is not prescribed in the Notice, except segregation of collateral is required if it is not re-hypothecated. If re-hypothecated, the requirement to segregate also extends to the third party.

2) List of eligible collateral has been included – initial margin may comprise of cash and/or specified non-cash collateral. ODPs/counterparties are encouraged to have diversified collateral.

3) Disagreed. Collateral can be categorised as initial margin or variation margin - word is used interchangeable, see the revised Notice.

| | secured party pursuant to the pledge arrangements or “flagged” pursuant to section 39 of the Financial Markets Act). Providers and counterparties should be able to agree methods of “posting” and it should not be prescribed – if however initial margin is to be posted by way of a pledge of cash it would, in our view, have to be effected by way of a pledge of a bank account as opposed to delivery of cash into a segregated “custodian”/“trust property” arrangement (as currently contemplated). We propose that parties be given the election in respect of the methods of posting and where cash initial margin is not elected between the parties to be posted by way of a “trust property” arrangement then the segregation provisions (among others) will not apply.

(2) It is not clear what “initial margin” may be comprised of – we suggest importing similar provisions to “Collateral Requirements” (Section 42 of the Financial Market Acts Regulations) given that this could be “posted” in the form of non-cash collateral.

(3) This is vague and meaningless. We propose that references to “collateral” are changed to “initial margin”.

| | The Margin Notice does not prescribe the method of posting collateral and there is no restriction on the type of collateral.
security”. Upon insolvency of counterparties “initial margin” amounts shall fall outside of the statutory netting arrangements (which is entirely in contrast to current market margin posting arrangements). We re-iterate our view that providers should be able to agree with counterparties on method of posting.

<table>
<thead>
<tr>
<th>Exclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peregrine/ACTSA SABMiller</td>
</tr>
<tr>
<td>9 (1 – 3)</td>
</tr>
<tr>
<td>Replace 9(1), 9(2) and 9(3) with sections set out below.</td>
</tr>
</tbody>
</table>

Page 12 of the Policy Document under the heading “Capital Requirements and margins on non-centrally cleared OTC derivatives” refers to non-bank financial institutions.

We have several comments with regards to the exclusions

There needs to be a clear distinction between clients and counterparties as OTC providers should not provide collateral to clients. Clients do not generally have the capacity to hold collateral and generally are not systemically important to economies.

There should also be scope for several other exclusions to limit cases where entities are unintentionally brought into the net and there is an unintentional requirement for the exchange of initial margin

| Amendments have been made to provisions to clearly distinguish clients from counterparties. Please refer to paragraph 2.2 for the treatment of intra-group transactions. |
| New thresholds included. |
| See the revised Notice. |
Thresholds need to be calculated on initial margin requirements and not gross OTC books. Different asset classes have different types of risks and these risks should be covered in the calculation of the margin. It would be also be more appropriate to set thresholds on a bilateral basis depending on the type of counterparty.

Replace 9(1) with:

“(1) An OTC derivatives provider is excluded from providing initial margin in terms of this Notice on OTC derivative transactions between OTC derivative providers and clients.”

This is in line with the requirements of Key principal 2, page 10, paragraph 2.6 of the BCBS-IOSCO Framework, which states:

“Only non-centrally cleared derivatives transactions between two covered entities are governed by the requirements in this paper.”

Covered entities are define in 2.4 as: “financial firms and systemically important non-financial entities)”

Replace 9(2) with:

“(2) An OTC derivatives provider is excluded from providing
Initial margin on OTC derivative transactions executed with counterparties that form part of the same group, where a group means the group of entities with which it is consolidated for purposes of the international accounting standard to which the group adheres."

This is in line with the specifications of “Margin requirements for non-centrally cleared derivatives: Element 6: Treatment of transactions with affiliates” in the BCBS-IOSCO Framework.

In South Africa banks, insurers and financial entities as well as listed companies often have their JSE authorised users set up as separate legal entities for technical reasons and might use the authorised user to hedge.

Replace 9(3) with:

“(3) An OTC derivatives provider is excluded from providing initial margin to a counterparty where the value of the initial margin is less than R600 million (+- EUR50 m equivalent).”

This is in line with the requirements of Key principal 2, page 10, paragraph 2.2 of the BCBS-IOSCO Framework.

Under the BCBS-IOSCO Framework, all covered entities (essentially OTC derivatives providers and counterparties)
must exchange initial margin with a threshold not to exceed EURO 50m on a bilateral basis. The threshold is provided at the level of the consolidated group to which the threshold is being extended and is based on all non-centrally cleared derivatives between consolidated groups.

A provider, that is not a bank or an insurer, is excluded from the requirement to provide initial margin in terms of this Notice if the value of its OTC derivative book, calculated on a group consolidated basis with entities that are not group entities, is less than R50 million the amount notified by the Registrar.

Corporates that are not banks or insurers but that do get caught in the definition of “provider” in the Regulations should be subject to a higher threshold for margining in line with equivalent overseas regulation and should not be subject to margining within their group.

- Thresholds should be separately notified by the Registrar from time to time so that they can easily be harmonized with overseas thresholds and can reflect changes in exchange rates.
- The exchange of initial or variation margin among affiliated parties is not customary and would create additional liquidity demands on corporates (see BCBS IOSCO Framework page 22).
Under EMIR non-financial corporates become subject to central clearing and margining at thresholds far exceeding R50 million, for example EUR3 billion in respects of each interest rate derivatives and commodity derivatives, taken separately (see HL Summary page 4).

| ACTSA  | 9(4) | A provider is excluded from the margin requirements set out in this Notice when the counterparty to the non-centrally cleared OTC derivative transaction is:
|        |      | (a) a central bank or other national monetary authority of any country, state or territory;
|        |      | (b) a sovereign state;
|        |      | (c) a multilateral development bank; or
|        |      | (d) the Bank for International Settlements.; or
|        |      | (e) a non-financial entity hedging or mitigating commercial risk.

If counterparties and clients will both be covered by the Notice, non-financial corporates hedging commercial risk should not be subject to margining.

- Non-financial corporates do not have the necessary infrastructure to receive margin.
- One key purpose of such hedging by corporates is to provide corporates with cash certainty. If a corporate is required to provide initial and variation margin on a hedge, that cash certainty is diminished by the need to exchange cash on a frequent and

Noted. The margin requirements extend to covered entities specified in the revised Notice.
unpredictable basis.
- This is reflected in the BCBS IOSCO Framework in paragraph 2(c) on page 8, which states that only transactions between financial firms and systemically important non-financial entities are covered by the margin requirements in the BCBS IOSCO Framework.

Under Dodd-Frank the margin requirements do not apply to non-financial entities hedging or mitigating commercial risk (see HL Summary page 24).

<table>
<thead>
<tr>
<th>Macquarie Securities (Round 2)</th>
<th>Thresholds</th>
<th>We propose that the thresholds be determined with reference to credit position of provider as the “value of OTC derivatives book” is not, in our view, necessarily a factor in determining likelihood of default.</th>
</tr>
</thead>
</table>
| Peregrine | Affiliates | Suggestion: transactions with affiliates should be excluded from the margining requirement

The Notice does not exempt transactions with “affiliates”. Key principle 6 of the BCBS-IOSCO Framework states posting of margin is “not customary” between affiliated parties. We recommend that group companies receive

Thresholds have been determined taking into account appropriate levels for local participants and based on recommended thresholds provided under the BCBS-IOSCO paper and not the value of the OTC derivatives book.

See the revised notice - intra-group transactions between covered entities/ODPs are excluded from the margin requirements, subject to the conditions specified in paragraph 2.2; however, it does not preclude
dispensation from these margin requirements. covered entities and affiliates from managing risks from those exposures.

### Margin Requirement - Phase in and Transitional arrangements

<table>
<thead>
<tr>
<th>IG Markets</th>
<th>Section 10 – Phase in periods</th>
</tr>
</thead>
<tbody>
<tr>
<td>As with all significant legislation, it is important that care is taken to ensure that an appropriate timescale is agreed to allow all affected participants to implement any necessary steps to adhere and conform to the new legislation. Pro-active consultation from National Treasury and other stakeholders until now has been appreciated and we welcome this continued approach as we enter stages of implementation. By way of example, of those systemic entities that are subject to EMIR in the EU, the least systemic entities that are caught (as retail clients and natural people and the majority of other non-financial market participants are exempt) are subject to the initial margin obligations from 1 September 2020.</td>
<td>The requirements follow a phased-in timeline approach.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Peregrine</th>
<th>Phase-in periods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insert 10 (and renumber section 10 as section 11): <strong>“10. Phase-in of Requirements”</strong> Suggestion: include phase-in provisions Principle 5 of the Policy Statement is “Minimising Market Disruption”. Similarly, Key principle 8 of the BCBS-IOSCO</td>
<td>Margin requirements will be phased-in. Please refer to the revised Notice.</td>
</tr>
</tbody>
</table>
Framework acknowledges the need to balance the need for systemic risk reduction against the liquidity, operational and transition costs that will be associated with implementing the requirements. The BCBS-IOSCO Framework therefore includes a number of phase-in provisions. We suggest that the sudden implementation of the requirements of the Notice will cause market disruption, and therefore phase-in provisions similar to those contained in the BCBS-IOSCO Framework should be included in the Notice.

Insert 10 (and renumber section 10 as section 11):

“10. Phase-in of Requirements”

To minimise market disruption, the requirements of the Notice should be phased-in as suggested in Element 8 of the BCBS-IOSCO Framework. The phase-in provisions should be based on Requirement 8 of the BCBS-IOSCO Framework beginning on page 24.

<table>
<thead>
<tr>
<th>Purple group</th>
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</thead>
<tbody>
<tr>
<td>The FMA Margin Requirements Regulations, in respect of margin requirements should introduce a phase-in time-table that takes cognisance of the systemic risk posed by certain OTC derivative book sizes, balanced by the impact that the initial margin requirements will have on the applicable entities. This timetable should similarly to the BCBS-IOSCA Framework stretch out over a reasonable period of around five years.</td>
</tr>
</tbody>
</table>

We have considered the comments and have made amendments to the provisions in the revised Notice. New thresholds are proposed in the revised Notice. The margin requirements will be phased-in. Refer to the revised Notice.
Consideration should also be given to excluding certain covered entities from the initial margin requirements of these regulations based on the nominal size of their OTC derivative book. The exclusions detailed in the current FMA Margin Requirements Regulations appear appropriate for an Initial Margin threshold (not nominal), in respect of OTC derivatives traded between two parties, however, cannot be systemically important from a total OTC Providers entire derivative book. With this threshold being EUR 8 billion in the BCBS-IOSCO Framework, it would appear that the current exclusion threshold in the FMA Margin Requirements Regulations is significantly understated.

It is critical to get the various thresholds reasonable and correct, as on the one hand you want to address systemic risk, yet on the other, you cannot afford to unnecessarily impact the current status quo or competitively prejudice local OTC Providers, compared to their international counterparts;

<table>
<thead>
<tr>
<th>Macquarie Securities (Round 2)</th>
<th>Timelines</th>
<th>See “General Comments” – it is essential that the “parameters” are fixed before allowing a transitional period (at least 18 months, in our view) before compliance is required.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macquarie Securities (Round 2)</td>
<td>Margin Requirements Timelines</td>
<td>Compliance with this notice will require a significant amount of time, human resources and costs – in particular, collateral segregation, reporting, contractual arrangements, internal risk management system development/remodelling.</td>
</tr>
</tbody>
</table>

A phased-in timeline is provided for in the revised Notice.

Noted. Transitional arrangements will be considered. Reasonable time will be provided to market participants to implement the
It is paramount that the market be given sufficient time to take the appropriate steps so as not to add to systemic risks inherent in the OTC derivative markets. At present there are NO transitional arrangements in the wording of the regulations that allow for this.

<table>
<thead>
<tr>
<th>Margin requirements - Re-hypothecation, Re-pledge or Re-Use</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Barclays</strong></td>
</tr>
</tbody>
</table>
| To prevent the loss of liquidity in the bond and equities markets, it is an imperative that providers are permitted to re-hypothecate or re-use collateral subject to the conditions as provided in the BCBS-IOSCO framework. It is also strongly recommended that, before implementation of this Board Notice, that the FSB and SARB jointly conduct a QIS to determine the impact of the provisions of this Board Notice, including the prohibition of re-hypothecation, on liquidity in the South African markets. In particular, the QIS should focus on the impact on South African banks in respect of the implementation of the LCR and NSFR requirements should these liquid assets be used for initial margin requirements.  

(Re-pledge- The legal and regulatory environment in South Africa does not support the concept of pledging, consequently collateral is either transferred outright or ceded) |
| Changes have been made to the requirements noting the concerns over the challenging environment and liquidity demand stresses, however, the framework still considers the risks that will be introduced from extended exposure, i.e. credit risk to the counterparties involved. Therefore, **only one time** re-hypothecation is permitted as specified in the revised Notice. |
Re-hypothecation is the process whereby a financial market participant reuses, for its own use, the collateral ceded by counterparty. This ability is an important feature of fungible securities when used as collateral. A clearing bank’s ability to fund the activities of its client base is largely predicated on its ability to raise such funding via the use of the assets provided by a counterparty. If a bank cannot re-use collateral, it would need to price transactions at unsecured levels (not from a credit perspective, but from an inability to raise secured funding). We recommend that the QIS, advocated above, includes an analytical assessment to determine the second order effects on market liquidity, which could render some business activities unviable (due to the increased funding cost) and could lead to market participants exiting business lines or activities.

It is acknowledged that limiting the re-use of collateral mitigates credit risk, however this limitation introduces liquidity risk as there is an increasing demand for banks to hold high quality liquid assets under the Basel III requirements (specifically, LCR).

The recently released hedge fund regulations make specific reference to the use and management of re-hypothecation agreements. The collateral management solution currently being implemented by Strate provides the facility for tracking of collateral transferred under cession and provides a
A central registry for the tracking thereof. This provides a mechanism to track the on-use of collateral and thereby manage limit the re-use.

A more prudent approach to the margining requirements for non-centrally cleared derivatives, aligned to the conditions provided for in the BCBS—IOSCO framework, would be to recognize the importance of re-hypothecation of assets and to apply some form of limit to —

(i) the maximum level of re-hypothecation allowed (relative to the level of indebtedness); and

(ii) the re-use of collateral (which the Strate collateral solution facilitates).

**Peregrine**

*Suggestion: re-hypothecation should be regulated but not prohibited*

Key principle 5 of the BCBS-IOSCO Framework (paragraph 5 (v)) allows re-hypothecation to a third party of cash and non-cash collateral collected as initial margin from a customer. This is however subject to conditions that protect the customer’s rights in the collateral.

The draft regulation propose that counterparties that collect initial margin are prohibited from re-hypothecating, re-

Amendments have been incorporated in the revised Notice in respect of re-hypothecation. Please see the revised Notice.
pledging or otherwise re-using the collateral which could potentially dilute the effectiveness of its role in reducing overall systemic risk, since the counterparty runs the risk of its margin being trapped by that third-party, in the event of the re-hypothecator’s default.

This is a slightly more restrictive approach than provided for in the BCBS-IOSCO Framework, where re-hypothecation would be allowed, subject to a comprehensive set of conditions.

We are of the opinion that controlled rehypothecation should be allowed and have proposed wording in this regard in the attached Annexure.

We also note that rehypothecation has been allowed in terms of the recently published Hedge Fund.

<table>
<thead>
<tr>
<th>Peregrine</th>
<th>Annexures</th>
<th>Annexure A, 2.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>“…products referred in paragraph 1 2 …”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Incorrect reference.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Annexure A, 3(c) - Change numbering to 4 and renumber remaining paragraphs accordingly.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Paragraph 3(c) is applicable to all initial margin calculations, not only to transactions that fall within more than one category.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Annexure B - Add new Annexure B</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Annexure B should be based on Appendix B of the BCBS-</td>
</tr>
</tbody>
</table>

Annexures have been updated to refer to the revised Notice.
| JSE | Annexure A - paragraph 2 | Incorrect reference to ‘paragraph 2’ should instead be ‘paragraph 1’. | Noted. Please see the revised Notice. |