South African Reserve Bank
From the Office of
the Registrar of Banks

D14/2013

2013-12-17

To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Directive 14/2013 issued in terms of section 6(6) of the Banks Act, 1990

Transitional arrangements related to capital requirements for over-the-counter derivatives that are not transacted through a central counterparty

Executive summary

The Office of the Registrar of Banks (this Office) hereby informs all relevant persons of the capital requirements to be applied to specified transactions in over-the-counter (OTC) derivatives for the period 1 January 2014 until 31 December 2014.

1. Introduction

1.1 The Regulations relating to Banks (the Regulations) include capital requirements related to banks' exposures to OTC derivatives, exchange-traded derivatives and securities-financing transactions. These capital requirements vary according to the degree to which the derivative instruments (derivatives) are traded through a central counterparty (CCP). Their objective is to encourage the trading of derivatives on exchanges or, in instances where derivatives are traded on an OTC basis, that they be settled through a CCP so as to reduce counterparty credit risk (CCR).

2. OTC derivative clearing

2.1 At the date of publishing this directive, no licensed, qualifying CCP provides clearing services for OTC derivatives in South Africa. Consequently, banks registered in South Africa have no alternative but to absorb the full impact of the increased capital requirements specified in the Regulations for domestically traded OTC derivatives.

3. Domestic currency OTC derivatives and OTC derivatives with local counterparties

3.1 After consideration of the incentives for banks to commence clearing OTC derivatives through a domestic qualifying CCP, the transitional arrangements specified herein shall apply to the credit valuation adjustment (CVA) risk component of capital requirements emanating from banks' exposures to OTC derivatives that are denominated and transacted solely in South African rand (denoted ZAR-OTC derivatives), as well as all OTC derivatives entered into bilaterally between local counterparties (denoted local-OTC derivatives).[1]

3.2 In compliance with the relevant requirements specified in the Regulations, banks and controlling companies are required to treat ZAR-OTC derivatives and local-OTC derivatives that are not cleared through either a domestic or non-domestic CCP as bilateral trades. Banks shall report and calculate the capital requirement for the default risk component of CCR on the basis of the capital requirements for a bilateral trade. However, the capital requirement for CVA risk shall be reported and calculated as follows:

3.3 For the purposes of *reporting* a bank's capital requirements for ZAR-OTC derivatives and local-OTC derivatives, the bank shall report the relevant required amounts on the form BA 200 in full compliance with the requirements specified in the Regulations. Banks that report according to the standardised approach for credit risk shall report the CVA exposure related to OTC derivative trades in accordance with the relevant requirements, in columns 26 and 27 of line 80 of the form BA 200, and in lines 92 to 99, not excluding reporting CCR exposures in other relevant line items and columns, without alteration. Banks that have applied for and have been granted permission to use the internal ratings-based approach for credit risk shall report the relevant required CVA risk information in full in columns 26 and 27 of line 280 and in lines 287 to 294 of the form BA 200.

3.4 In accordance with the provisions of regulation 38(8)(c) of the Regulations, from 1 January 2014 until 31 December 2014, or prior notice specified in writing, for the purposes of *calculating* the capital requirement for ZAR-OTC and local-OTC derivatives associated with the reported CVA risk exposure, the bank shall be required to hold **zero per cent** of the capital requirement for CVA risk, as reported on the form BA 200. Furthermore, from 1 January 2014 until 31 December 2014, or prior notice specified in writing, no amount for CVA risk capital related to the aforesaid ZAR-OTC and local-OTC derivatives shall be reported as part of the total requirement for CCR in column 2 of line 1 of the form BA 700.

[1] For purposes of this directive, local-OTC derivatives mean OTC derivatives entered into bilaterally between South African counterparties. Locally registered branches of foreign banks are regarded as South African counterparties for this purpose. Local-OTC derivatives may include OTC derivatives not denominated solely in ZAR.

4. Complete framework

4.1 No other capital requirements as articulated in the Regulations will be affected by the above-mentioned transitional arrangements.

5. Acknowledgement of receipt

5.1 Two additional copies of this directive are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.

Registrar of Banks

The previous directive issued was Directive 13/2013, dated 28 October 2013.