South African Reserve Bank
Prudential Authority

FSCA
Financial Sector
Conduct Authority

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

Joint Standard 2 of 2020 - Margin requirements for non-centrally cleared over-the- counter derivative transactions

As published on 2 June 2020

* This statement is prepared and published in accordance with and in fulfilment of the requirements under section 98(1) and 103 of the Financial Sector Regulation Act, No. 9 of 2017. This statement was finalised in October 2019.

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1. Introduction

1.1 Section 98 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSRA) requires the maker of a regulatory instrument (i.e. a prudential, conduct or joint standard) to publish the following documents before making such regulatory instrument:

(i) a draft of the regulatory instrument;
(ii) a statement explaining the need for and the intended operation of the regulatory instrument;
(iii) a notice inviting submissions in relation to the regulatory instrument, stating where, how and by when submissions are to be made; and
(iv) a statement of the expected impact of the regulatory instrument.

1.2 In line with the requirements under the FSRA, the Prudential Authority (PA) and Financial Sector Conduct Authority (FSCA) (jointly referred to in this document as the Authorities) have prepared a Statement of the need for, intended operation and expected impact (Statement) of the Joint Standard on margin requirements for non-centrally cleared over-the counter (OTC) derivative transactions (Joint Standard). The Statement also seeks to inform the approach undertaken by the Authorities in making the Joint Standard.

1.3 The Statement has been prepared having collated and analysed the responses[1] received to a questionnaire that was circulated to the industry by the Authorities to solicit industry inputs on the expected impact of implementing the Joint Standard.

2. Objectives of BCBS-IOSCO margin requirements

2.1 In 2011, the G20 mandated the Basel Committee on Banking Supervision (BCBS) and International Organisation of Securities Commissions (IOSCO) to develop standards on margin requirements for non-centrally cleared OTC derivatives in order to offer enhanced protection against counterparty credit risk.

2.2 In terms of the BCBS-IOSCO Framework, margin requirements for non-centrally cleared OTC derivatives have two main benefits: (i) reduction of systemic risk[2] and (ii)

[1] Responses were received from 19 respondents that included banks, insurers and asset managers.

[2] In terms of the BCBS-IOSCO Framework margin requirements for non-centrally cleared derivatives would be expected to reduce contagion and spillover effects by ensuring that collateral is available to offset losses caused by the default of a derivatives counterparty.

promotion of central clearing[3]. Margin requirements are distinct from capital requirements but both perform important and complementary risk mitigation functions.[4]

3. Statement of the need — Context and definition of policy problem

3.1 Although derivatives are used to mitigate or transfer risk between counterparties, they do not eliminate all the risks. Derivative dealers and end-users are exposed, in varying degrees, to market, credit, legal, operational, liquidity, as well as legal risk. In the event that the aforementioned risks are not properly and effectively managed, this may pose systemic risk to the financial system as was experienced during the 2008 global financial crisis.

3.2 In a paper issued by the Joint Forum[5], which was tasked to investigate the 2008 global financial crisis, the following weaknesses in the regulation of the financial system were identified:

- insufficient use of collateral;
- inadequate risk management practices and infrastructure;
- inadequate risk governance;
- lack of transparency to both regulators and participants; and
- vulnerable market infrastructure.

3.3 The global financial crisis highlighted that further regulation of OTC derivatives market would be necessary to reduce excessive risk-taking by market participants in order to mitigate the systemic risk posed by OTC derivative transactions.

3.4 In response to the weaknesses identified in the supervisory and regulatory framework of OTC derivatives, the Group of Twenty (G20) Leaders at the Pittsburgh Summit[6] in 2009 pledged to reform OTC derivative markets in order to improve their transparency, prevent market abuse and reduce systemic risk. The G20 Leaders initiated a reform programme to reduce the systemic risk from OTC derivative transactions. The reform programme comprised of the following four key elements:

[3] In terms of the BCBS-IOSCO Framework margin requirements on non-centrally cleared derivatives, and reflecting the generally higher risk associated with such derivative transaction will promote central clearing and therefore make the G20 reform agenda more effective.
[4] See BCBS-IOSCO Framework at page 4.
[5] The Joint Forum comprises representatives from the Basel Committee on Banking Supervision, the International Organisation of Securities Commissions, and the International Association of Insurance Supervisors. Please see The Joint Forum 2010: Review of the Differentiated Nature and Scope of Financial Regulation. Basel, Switzerland: Basel Committee on Banking Supervision: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD315.pdf
[6] See the G20 Leaders' Statement from the Pittsburgh Summit accessible at the following link: file:///C:/Users/P517380/Downloads/G20-declaration-pittsburgh-2009-en%20(1).pdf

- all standardised OTC derivatives should be traded on exchanges or electronic platforms, where appropriate;
- all standardised OTC derivatives should be cleared through central counterparties (CCPs);[7]
- OTC derivatives contracts should be reported to trade repositories;[8] and
- non-centrally cleared derivatives contracts should be subject to higher capital requirements.[9]

3.5 In September 2013, the BCBS and IOSCO published an initial regulatory framework for margin requirements titled: *"BCBS-IOSCO Framework for Non-Centrally Cleared Derivatives"* (BCBS-IOSCO Framework). This initial draft framework was finalised in 2015 and it provided new regulatory guidelines to be adopted into the domestic laws of the respective G20 member states.

3.6 In order to ensure that South Africa's (SA's) legal framework for regulation and supervision of the financial sector adheres to the internationally agreed standards in line with the country's commitments under the G20, the National Treasury published a discussion document titled *"Reducing the risks of over-the-counter derivatives in SA"* in March 2012. The discussion document outlined SA's proposed policy approach to regulating OTC derivative markets.

3.7 Against the above background, the Joint Standard seeks to incorporate the BCBS-IOSCO Framework into the domestic regulatory framework to give effect to SA's commitment to making the OTC derivatives market safer.

[7] In order to give effect to the G20 clearing mandate, Regulation 4 of the Financial Markets Act Regulations as published on 9 February 2018 (FMA Regulations) provides that the FSCA may, with the concurrence of the Prudential Authority -
(a) determine eligibility criteria for OTC derivative transactions to be subject to mandatory clearing; and
(b) conduct assessments into other categories of OTC derivative transactions upon which additional mandatory clearing requirements could be based.
In addition, an authorised OTC derivative provider must ensure that an OTC derivative transaction determined by the Authority in terms of sub-regulation (1) as eligible for clearing, is cleared through a licensed central counterparty or a licensed external central counterparty in the manner prescribed by the Authority. The FMA Regulations also introduce a rigorous framework for the regulation of a central counterparty (CCP), recognising the cross-border systemic risk that these institutions pose and containing stringent prudential, governance and conduct requirements. The FMA Regulations can be accessed at the following link:
https://discover.sabinet.co.za/webx/access/netlaw/19_2012_financial_markets_16.pdf

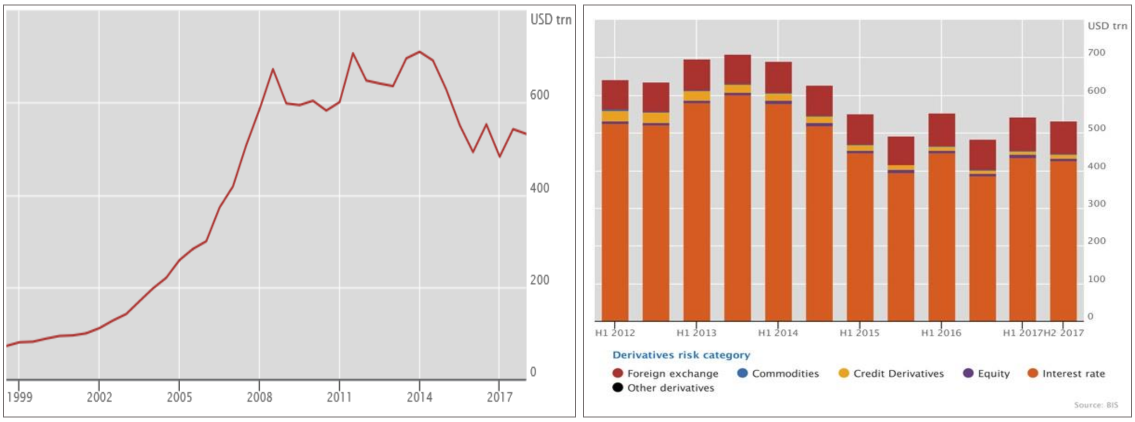
[8] The FSCA has finalised the Conduct Standard on Reporting Obligations (Reporting Obligations) which prescribes reporting obligations in respect of OTC derivative transactions. The Reporting Obligations is accessible at the following link: www.fsca.co.za In addition, the PA and the FSCA have finalised the Joint Standard on the Requirements and Additional Duties of a Trade Repository (TR Joint Standard), which sets out the requirements for a trade repository. The TR Joint Standard is accessible at the following links: www.fsca.co.za and www.resbank.co.za

[9] The BCBS has developed the international capital standard applicable to prudentially regulated entities that conduct activities in OTC derivatives markets. Basel III introduces the Credit Valuation Adjustment (CVA) as an additional capital requirement to counterparty credit risk related risk exposures. These new capital standards are aimed at encouraging the use of standardised, centrally-cleared transactions. The Bank Supervision Department issued a directive in terms of the Bank Act on 26 March 2015 directing banks to comply with specified capital requirements for OTC derivatives not transacted through a CCP from 1 April 2015, in accordance with the Basel III CVA capital rules. The directive can be accessed at the following link: http://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/6668/D5%20of%202015.pdf

4. Analysis of the current OTC derivative market

4.1 Globally, the OTC derivatives market is significant and has been growing since 1999 (see figure 1). According to the Bank for International Settlements (BIS), the size of the global OTC derivatives market as measured by the total gross notional amount of outstanding contracts amounted to USD532 trillion, as at December 2017. Interest rate derivative contracts accounted for 78% of the total gross notional global derivatives market.

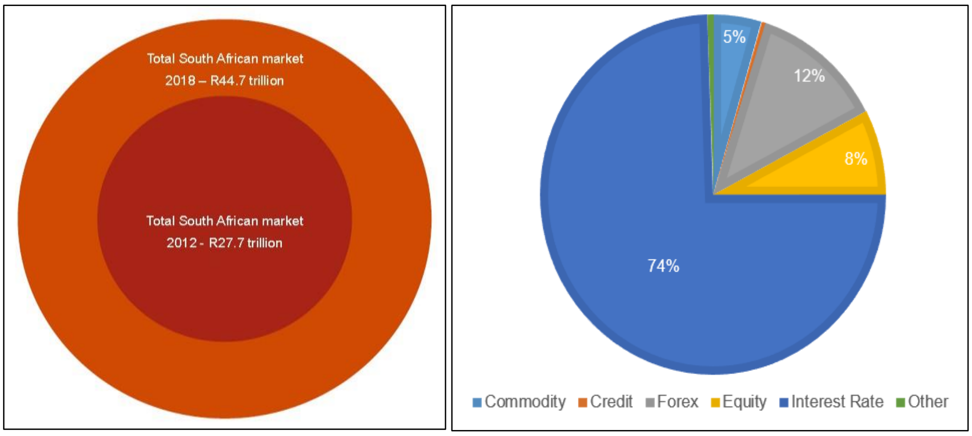
Figure 1: Size of the global notional OTC derivative market over the years and composition



Source: BIS

4.2 As a share of the global derivatives market, the SA market is quite small (less than 1%). SA's total gross notional outstanding OTC derivatives in 2018[10] was estimated at about R44.7 trillion, up from R27.7 trillion in 2012 (see figure 2).

Figure 2: Total South African OTC derivatives market size over the years and composition



Source: Research commissioned by the PA on OTC derivative market in SA and conducted by PwC

4.3 In line with the global trend, in 2018, interest rate derivative contracts accounted for 74% of the average gross notional outstanding OTC derivatives. Derivatives in foreign exchange, equities and commodities accounted for 12%, 8% and 5% respectively.

[10] This is according to a study on the OTC derivatives market in SA that was commissioned by the Authorities and conducted by PwC.

4.4 According to the information gathered from the returns submitted to the PA by the banks as well as an industry engagement conducted by the PA indicated that as at June 2018, the aggregate outstanding gross notional amount of OTC derivatives for banks amounted to approximately R39 trillion. The respondents to PA's industry engagement represent about 87% of the total derivatives market in SA.

5. Approach taken by the Authorities on the Joint Standard

5.1 The Joint Standard is closely aligned to the BCBS-IOSCO Framework. This is aimed at creating a level playing field among OTC derivative participants. In addition, the Authorities acknowledge that SA's market participants also interact with foreign counterparties from more developed markets such as the European Union (EU) or United States of America (USA), and failure to adopt or implement the BCBS-IOSCO Framework will create disparities for local market participants and may result in regulatory arbitrage. However, incorporating the international standard into the domestic regulatory framework must take into account the nature of the domestic legal framework and local market conditions.

5.2 The Authorities have therefore made adjustments to the international framework for non-centrally cleared OCT derivatives in light of SA's specific market conditions. In drafting the margin requirements, the Authorities have adapted the requirements in the BCBS-IOSCO framework in the following areas highlighted in table 1:

Table 1: Approach in the adoption of the BCBS-IOSCO framework into domestic regulatory framework

BCBS-IOSCO Framework	Policy approach by the Authorities
Thresholds: Reference to foreign currency (Euros) in setting the thresholds.	The Authorities adopted a set conversion rate of €1:R10 to convert the foreign currency thresholds into Rands in the domestic legal framework.
Scope of coverage: covered entities are financial firms and systemically important non-financial firms (covered entities). The precise definition of financial firms, non-financial firms and systemically important non-financial firms will be determined by appropriate national regulation.	In order to ensure close alignment with the BCBS-IOSCO Framework it is proposed that the scope of coverage of the Joint Standard be applied to OTC Derivative Providers (providers) and counterparties as defined in the Joint Standard. The Joint Standard also allows the Authorities to declare any other person as a "counterparty". This will allow the Authorities the flexibility to bring other entities within the ambit of the Joint Standard.
Intra-group transactions: the specific legal and regulatory frameworks governing inter-affiliate derivative transactions depend largely on specific features of applicable jurisdictions.	The Authorities do not support an outright exemption from the margin requirements for intra-group transactions. The Joint Standard provides that the non-centrally cleared OTC derivative transactions between a provider and a counterparty belonging to the same group, below an aggregate outstanding gross notional amount of R100 billion will be exempt from the margin requirements, subject to certain conditions specified in the Joint Standard. If the value

	of the intra-group transactions exceeds the threshold (R100 billion), the entities would be required to exchange margin. However, the minimum transfer threshold of R5 million will apply to all margin transfers in respect of the initial margin, variation margin and intragroup transactions.
Cross-border OTC derivative transactions: home-country supervisors may permit a covered entity to comply with margin requirements of a host-country with respect to its derivatives activities, provided that the home-country supervisors consider the host-country margin regime to be consistent with the margin requirements in the BCBS-IOSCO Framework.	A local counterparty that enters into an OTC derivative transaction with a foreign counterparty is deemed to comply with the Joint Standard provided that the local provider has satisfied itself that (i) the foreign jurisdiction has implemented margin requirements based on the BCBS-IOSCO Framework; (ii) the foreign counterparty is directly subject to such margin requirements; and (iii) the local counterparty is required to comply with, or is captured by, the margin requirements in the foreign jurisdiction.
Treatment of physically settled FX forwards and swaps: the BCBS and IOSCO agree that standards apply for variation margin to be exchanged on physically settled FX forwards and swaps in a manner consistent with the final policy framework set out in the BCBS-IOSCO framework and that those variation margin standards are implemented either by way of supervisory guidance or national regulation.	Physically settled FX forwards and swaps are excluded from VM in line with other jurisdictions. In this regard, the Authorities are concerned around the practicality of requiring local ODPs to be subjected to VM for these transactions if the counterparty in another jurisdiction is not required to exchange VM. However, the Authorities do not support excluding physically settled FX forward and swap transactions from the calculation of the daily intragroup threshold – these transactions are also taken into account in the calculation of the IM threshold even though these transactions are not subject to the exchange of IM.

5.3 The Authorities acknowledge that currently there is no licensed CCP or licensed external CCP in SA.[11] However, the Financial Markets Act, 2012 (Act No. 19 of 2012) (FMA) and the FMA Regulations create the required regulatory framework for the licensing and regulation of a CCP or a licensed external CCP. Notwithstanding the fact that there is no licensed CCP in SA, the margin requirements for non-centrally cleared OTC derivative transactions aim to reduce systemic risk and can have broader macroprudential benefits by reducing financial system vulnerabilities caused by build-up of uncollateralised exposures within the SA financial system.

6. Statement of expected impact — Costs and benefits of the Joint Standard

6.1 Derivative market participants that responded to the survey conducted by the Authorities had a combined outstanding gross notional OTC derivative exposures amounting to R31.4 trillion.[12] The majority (99%) of the aggregate outstanding gross

[11] The Authorities acknowledge that on 10 December 2012, the Registrar of Securities Services approved JSE Clear as a qualifying central counterparty for listed derivatives on the basis that JSE Clear complied with the Principles for Financial Market Infrastructures (PFMIs).
[12] As at April 2018.

notional OTC derivatives were held by banks and asset managers and insurers accounted for the remainder of the balance.

6.2 The Joint Standard outlines a phased-in approach (from a date of implementation to be determined by the Authorities, until 2024), for the exchange of initial margin (IM) by providers when transacting with counterparties that also meet the conditions related to the aggregate gross notional amount of OTC derivatives outlined in Table 2.

6.3 In respect of variation margin (VM), during the first six months of implementation and commencement of the Joint Standard, VM will only be exchanged by providers and counterparties where the gross notional amount of OTC derivatives is R30 trillion and above. After the first six-month period, all derivative providers entering into non-centrally cleared OTC derivatives transactions with counterparties will be required to exchange VM on all new contracts. However, this will be subject to a de-minimis minimum transfer amount not exceeding R5 million and in accordance with the relevant requirements specified in the Joint Standard.

6.4 An assessment of how different stakeholders such as banks and non-banks will be impacted by the Joint Standard in as far as the IM is concerned has been anchored on the phased-in approach of qualifying aggregate notional OTC amounts outlined in Table 2.

Table 2: Phasing-in of qualifying aggregate notional amounts relating to IM

Year	Qualifying Aggregate Notional Amount
From effective date until 31 August 2021	**R30 trillion**
From September 2021	**R23 trillion**
From September 2022	**R15 trillion**
From September 2023	**R8 trillion**
From September 2024	**R100 billion**

6.5 The majority of market participants that responded to the questionnaire had gross notional OTC derivatives amounts substantially below the R100 billion threshold that will come into effect in 2024. Out of the 19 respondents, 13 had outstanding gross notional OTC derivatives amounts below R100 billion ranging from R750 million to R55 billion. Six respondents had outstanding gross notional OTC derivatives amounts ranging from R120 billion to R15 trillion.

6.6 The thresholds in the Joint Standard are set at the level of the consolidated group. Stated differently, a provider or a counterparty belonging to a group whose aggregate outstanding average gross notional amount for a specified period exceed the specified aggregate gross notional thresholds in Table 2 will be required to exchange IM and VM[13] as outlined in the Joint Standard.

6.7 The definition of a "group" in the Joint Standard is based on the definition of a "group of companies" as defined in the Companies Act, 2008 (Act 71 of 2008). In its current formulation, the reference to the holding company in the context of a group of companies is not limited to SA incorporated holding companies.

Impact on banks

6.8 An analysis of the information from banks submitted through the different statutory returns[14] to the PA as well as information gathered through the survey conducted by the PA indicates that out of the 34 banks regulated by the PA (including branches of foreign banks), 99.72% of the total gross notional outstanding OTC derivatives amounting to R37 trillion as at June 2018 is attributable to only 10 banks (including branches). The 10 banks (including branches) alluded to above have a total outstanding notional OTC derivative amounts that range from R100 billion to R15 trillion.

6.9 However, the OTC derivative exposures for branches of foreign banks are in respect of their SA operations and the notional amounts will be quite high at a consolidated level when the operations of their parent/ holding companies are taken into consideration. The Authorities did not have an opportunity to analyse the consolidated notional derivatives exposures at the parent or holding company level for branches of foreign banks operating in SA. However, an analysis of the OTC derivative exposures of parent companies for 2 large branches out of the 10 that have exposure in the OTC derivatives market indicates that they will trigger the thresholds for margin requirements on the basis of the size of the outstanding non-centrally cleared OTC derivatives of their offshore parent companies.

6.10 Out of the 15 branches of foreign banks with operations in SA, 5 had no exposure in the OTC derivatives market and will therefore not be affected by the Joint Standard or requirements set out in the Joint Standard.

6.11 In addition to the 5 branches of foreign banks, 4 banks operating in SA did not have any exposure to the OTC derivatives market. Sixteen banks (including branches) had an aggregate outstanding gross notional amounts of OTC derivatives ranging from

[13] For VM, the thresholds will only apply for the first six months from the date of implementation after which all providers and counterparties will be required to exchange VM subject to the requirements set out in the Joint Standard.
[14] In terms of Banks Act, 1990 (Act 94 of 1990)

between R1 million and R50 billion. This is below the threshold for 2024 and assuming an annual growth rate in their OTC derivatives of 10%, from the date of implementation until 2024, they will still be below the threshold for 2024.

6.12 The comparison between the size of the OTC derivative market against the gross notional thresholds for IM requirements outlined in table 2 shows that most of the banks (excluding branches of foreign banks) will be below the threshold to exchange IM, from the date of implementation until 2021. A limited number of banks will reach the thresholds for exchanging of IM from 2022 onwards. However, six months after the commencement of the Joint Standard, all banks will be required to exchange VM, subject to relevant requirements specified in the Joint Standard.

6.13 In 2024 when the qualifying threshold reduces to R100 billion, all of SA’s largest 6 banks by asset size will be required to also exchange the IM.

6.14 Table 3 illustrates how the phasing-in of the qualifying thresholds will affect banks operating in SA (except branches of foreign banks).

6.15 While the qualifying thresholds for margin requirements are determined on the basis of the gross notional, non-centrally cleared OTC derivatives, in the case of SA the size of this market in 2018 was estimated to be R45 trillion. For the purposes of assessing the expected impact of the margin requirements on individual banks, the PA used notional OTC derivative amounts which include both centrally and non-centrally cleared OTC derivative exposures since these are the current known granulised figures. The assessment provides the worst case scenario given that the figures in table 3 might be overstated as they also include centrally cleared OTC derivatives — 11% of notional outstanding balance is currently cleared centrally.

Table 3: How SA banks (except branches of foreign banks) will likely be affected by the phasing-in of qualifying notional amount

Bank	Average notional OTC derivative amounts for April, May and June, 2018	Year when the bank is likely to qualify for margin requirements under the Joint Standard
1	R14.8 trillion	**2022**
2	R7.7 trillion	**2023**
3	R4.9 trillion	**2024**
4	R4.5 trillion	**2024**
5	R718 billion	**2024**
6	R6 billion	**N/A**
7	R4 billion	**N/A**

8	R2 billion	**N/A**
9	R1.5 billion	**N/A**
10	R1.2 billion	**N/A**
11	R789 million	**N/A**
12	R443 million	**N/A**
13	R417 million	**N/A**
14	R64 million	**N/A**
15	R55 million	**N/A**
16	Nil	**N/A**
17	Nil	**N/A**
18	Nil	**N/A**
19	Nil	**N/A**

Source: Compiled from information submitted by banks, through returns to the PA

6.16 The results of another survey conducted by the then Bank Supervision Department (BSD) of the South African Reserve Bank (SARB) during 2016 on the impact of the margin requirements for non-centrally cleared OTC derivative instruments on banks are presented in Box 1.

Box 1: Key findings of the impact of margin requirements on banks

Credit Risk Weighted Assets (RWA) reduced slightly as a result of minimum margin requirements on non-centrally cleared OTC derivatives, for all banks.

The leverage ratio will be negatively impacted, but only slightly. Banks use mainly cash as collateral and based on the leverage ratio requirements, cash variation margin may be viewed as a form of pre-settlement and therefore, may be deducted from the exposure measure if certain conditions are met. However, not all banks are capable of distinguishing between initial and variation margin or to meet all the conditions as per the leverage rules. If systems are improved, banks' leverage ratios would improve and benefit from the new margin requirements directive.

The liquidity coverage ratio (LCR) could be impacted as follows: Banks that are currently in a net receiving cash position for derivative instruments would have an improved LCR ratio as opposed to banks that are in a net paying cash position, whose overall cash outflow would not reduce. The new margin requirements would maintain the current status of both cash paid and cash received, however, both levels would increase. Most bank's LCR ratio would therefore decrease.

Impact on non-banks

6.17 All non-bank respondents to the questionnaire had aggregate gross notional amounts of OTC derivative transactions far below the thresholds set out in Table 2 and will not be required to exchange IM under the Joint Standard. It is therefore anticipated that the requirements for IM set out in the Joint Standard will have limited impact on non-bank market participants given the thresholds.

6.18 The largest non-bank respondent had an aggregate gross notional OTC derivative transactions amounting to R120 billion while the lowest had R750 million. The expected low impact of the Joint Standard on non-banks as it relates to the IM is also supported by the submission received from one of the industry associations that responded to the survey on behalf of its members who are non-banks. The industry association indicated that having assessed the contents of the Joint Standard, its members will not be impacted by the Joint Standard.

6.19 While the Joint Standard is anticipated to have limited impact on the non-banks as far as it relates to the IM, in respect to VM, all non-centrally cleared OTC derivative transactions entered into between a provider and a counterparty will be required to exchange variation margin six months after the implementation of the Joint Standard.

6.20 On the basis of the responses received to the survey, 16 respondents indicated that they already exchanged VM and 3 respondents indicated that they did not exchange VM. According to the results of the survey, 84% of the respondents already exchange VM, accordingly, the requirement for all providers and counterparties to exchange VM six months after the implementation of the Joint Standard will have limited impact given that the providers can leverage off their existing systems.

6.21 While a significant number of derivative counterparties have exchanged VM in the past, this has not been the case for IM. The counterparties will need to be ready, operationally and administratively to exchange IM, in order to comply with the requirements of the Joint Standard. This will require sufficient time and the proposed phase-in of thresholds provides sufficient time for the phasing-in of the counterparties to exchange margins.

Impact on collateral exchange

6.22 According to the responses received, 11 out of the 19 respondents confirmed to receiving or posting collateral in the form of cash. Only 8 respondents indicated that they receive non-cash collateral, primarily in the form of government bonds, over and above the cash collateral. Given that cash and government bonds are mainly used as collateral and attract 0% and between 0.5% and 4% haircut respectively, the expected impact of the Joint Standard emanating from the exchange of collateral is expected to be minimal.

Impact on intra-group exposures

6.23 In terms of the Joint Standard, derivative transactions between entities belonging to the same group (intra-group transactions) where the aggregate outstanding gross notional amount of OTC derivative transactions is below R100 billion threshold, will not require any margin to be exchanged. This is also subject to the specific conditions specified in the Joint Standard as well as the minimum transfer threshold of R5 million.

6.24 Out of the 19 respondents, only 3 had intra-group exposures above the R50 billion, ranging from R50 billion to R250 billion. In light of the R100 billion threshold for intra-group transactions, the margin requirements in respect of intra-group transactions is expected to only affect a limited number of market participants in South Africa.

Impact on the general operational and compliance costs

6.25 Margin requirements for non-centrally cleared OTC derivative transactions represent a significant policy shift, particularly in respect of IM requirements. Implementation of the Joint Standard by qualifying providers and counterparties will require operational enhancements and additional collateral. This will require that the impact on liquidity of providers be properly planned and managed.

6.26 The Authorities anticipate that the implementation of the Joint Standard would impact derivative providers and counterparties through direct costs that include:

- costs associated with IM accounts held at different custodians;
- additional compliance / legal resources;
- costs associated with sourcing securities to post as IM;
- additional system enhancements;
- additional human resources;
- additional reporting requirements; and
- additional regulatory and supervisory costs.

6.27 While there are potential costs associated with the Joint Standard, the phasing-in of the qualifying threshold for margin requirements, particularly the IM requirements will ensure that the objective of the standard to reduce systemic risk is appropriately balanced with the costs associated with implementing the margin requirements in SA.

6.28 According to the responses received, it will cost between R1 million and R65 million per institution to implement the margin requirements, assuming that all respondents would be required to exchange margin. The indicated costs varied across the different types and sizes of financial institutions that responded as outlined in Table 4.

Table 4: Expected costs for implementation of margin requirements

Entity[15]	Size (gross outstanding notional amounts)	Estimated weighted average cost as a percentage of the outstanding gross non-centrally cleared OTC derivatives amount
Small	R12-26 billion	0.060%
Medium	R35-47 billion	0.0049%
Large	R7-15 trillion	0.00046%

Source: Calculated from information received from the survey conducted by the PA

6.29 However, it must also be emphasised that a significant portion of these costs will be once-off setup costs that will be incurred in system development and enhancements for margin requirements. Recurrent and maintenance costs will be lower after the initial set-up costs.

Expected benefits of implementing margin requirements

6.30 The Joint Standard is intended to yield the following benefits:

- improved safety and soundness of financial institutions and consequently reduced systemic risk;
- protection against counterparty credit risk;
- reduction in risk-weighted assets;
- promotion of central clearing;
- IM will make derivative creditors more senior to other creditors since they may use initial margin to offset losses in a default scenario;
- the standardisation of margin requirements is expected to bring about consistent, visible and improved pricing across the OTC derivative market;
- international compliance is the main benefit and for financial institutions that trade across borders; and
- greater transparency to derivative markets.

Assessment of policy options considered by the Authorities

6.31 The Authorities could have maintained the status-quo and not implemented the OTC derivative margin requirements in SA. However, maintaining the status-quo and not implementing the margin requirements was not considered to be a viable option. The developments during the global financial crisis highlighted the risk of an unregulated OTC derivative market. The internationally agreed reforms to making OTC derivatives safer and more transparent are being implemented in other comparable jurisdictions.

[15] These entities have been categorised on the basis of the responses received from the survey conducted by the Authorities

6.32 SA's financial institutions transacting with foreign counterparties that are subject to margin requirements would also need to comply with the requirements from other jurisdictions without being able to benefit from substituted compliance or an equivalent assessment in respect of the South African regulatory framework. The resulting market fragmentation and reduced access to the global OTC derivatives market would be limiting to the SA financial institutions.

6.33 Implementation of the margin requirements will ensure that SA complies with its G20 commitments. The margin requirements will improve the safety and soundness of financial institutions by allowing large financial institutions, mostly systemically important financial institutions to exchange margin which also reduces counterparty credit and systemic risk.

6.34 The benefits that will accrue to the country through the implementation of the margin requirements outweigh the compliance costs that will be incurred by some of the entities particularly in the first phases of implementation through the set-up costs as and when entities qualify to exchange margins. Table 5 summarises the assessment of the two options that were considered, namely (1) maintaining the status-quo and (2) implementing margin requirements in SA.

Table 5: Assessment of the options against key objectives of the joint standard

Key objective	**Status-quo**	**Implement margin requirements**
Compliance costs	Neutral	Minimum
Meets the objectives envisaged by the BCBS-IOSCO	Does not meet this requirement	Meets this requirement
Improves safety and soundness of financial institutions	Does not meet this requirement	Meets this requirement
Establishes a broadly internationally consistent framework	Does not meet this requirement	Meets this requirement
Satisfies SA's G20 Commitments	Does not meet this requirement	Meets this requirement
Overall Assessment	**Negative net benefit**	**Positive net benefit**

6.35 While all derivative providers and counterparties will be required to exchange VM on a bilateral basis 6 months after the commencement of the Joint Standard in accordance with the relevant requirements specified in the Joint Standard, it must be noted that until 2022, none of the respondents to the survey or any of the banks in SA (except branches of foreign banks) will meet the thresholds to exchange of IM under the Joint Standard.

7. Consultation

A separate report on the consultation process as well as the general account of the issues raised during all the public consultation processes has been prepared by the Authorities, pursuant to section 103 of the FSRA. The Authorities have made certain amendments and refinements to the Joint Standard in response to the public consultation process.

8. Statement of intended operation — Implementation and evaluation

8.1 The Joint Standard is envisaged to be implemented with effect from a date that will be determined by the Authorities and communicated to the industry.

8.2 Following the implementation of the Joint Standard, the Authorities will assess and evaluate the effect of the Joint Standard on a continuous basis as part of the Authorities' regulatory and supervisory responsibilities to ensure that any unintended consequences of the Joint Standard on the industry are adequately addressed.

9. Conclusion

The Joint Standard and this Statement were prepared in terms of section 98(1) of the FSRA and published in terms of the requirements in section 98(2) and section 99 of the FSRA and take into consideration all submissions received during the public consultation process.