



South African Reserve Bank

Prudential Authority

DRAFT FOR CONSULTATION

Financial Sector Regulation Act, 2017 (Act No. 9 of 2017)

Prudential Standard RA01 - Stays on Early-Termination Rights and Resolution Moratoria on Contracts of Designated Institutions in Resolution

Objectives and key requirements of this Standard

This Standard sets out the principles and requirements for stays on early termination rights and resolution moratoria on contracts of designated institutions in resolution that must be complied with by all designated institutions, in line with sound principles, practices and processes for the orderly resolution of a designated institution.

This Standard provides for the adoption of contractual recognition in certain types of contracts that are governed by foreign law and gives effect to the objective(s) and requirements of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) as amended by the Financial Sector Laws Amendment Act, 2021 (Act No. 23 of 2021) relating to stays on early termination rights and resolution moratoria on contracts of designated institutions in resolution.

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1. Commencement

1.1 This Standard comes into effect on Day-Month-Year.

Version number	Commencement date
01	Day -Month-Year

2. Legislative authority

2.1 This Standard is made under section 105(2)(c) of the Act.

3. Definitions and interpretation

3.1 In this Standard, any word or expression to which a meaning has been assigned bears the meaning so assigned to it by the Act unless the context indicates otherwise –

‘the Act’ means the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act) as amended by the Financial Sector Laws Amendment Act, 2021 (Act No. 23 of 2021);

‘compliant covered contract’ means a contract whose terms and conditions make provision for parties to such a contract to agree to be bound by temporary stays on the exercise of early-termination rights imposed by the SARB;

‘contractual recognition approach’ means an approach in terms of which a designated institution ensures that the terms and conditions of a covered contract entered into by the designated institution provides for an acknowledgement and acceptance by the parties that such covered contract may be subject to temporary stays that may be imposed by the SARB on the exercise of early termination rights that would arise solely on the basis of the SARB’s decision or proposal to take a resolution action in relation to the designated institution;

‘covered contract’ means a contract that meets the criteria stipulated under paragraph 5.5 below;

‘critical function’ means, as defined in the Act, in relation to a designated institution, a function that is –

(a) essential to, or that contributes substantially to, financial stability and is performed by the designated institution; and

(b) provided to, and essential to the continued operation of, the designated institution;

‘designated institution’ means a designated institution as defined in section 29A (1) of the Act;

‘designated institution in resolution’ means, as defined in section 1 of the Act, a designated institution in respect of which a determination in terms of section 166J (2) of the Act is in force;

‘governing body’ means a governing body as defined in section 1 of the Act;

‘holding company’ means a holding company as defined in the Companies Act, 2008 (Act No. 71 of 2008);

‘market infrastructure’ means a market infrastructure as defined in section 1 of the Act;

‘master agreement’ means a standard document outlining the terms to be applied to a derivatives transaction between counterparties and published by the International Swaps and Derivatives Association for purposes of governing transactions in over-the-counter derivatives;

‘orderly resolution of a designated institution’ means, as defined in section 1 of the Act, the management of the affairs of the designated institution as provided for under Chapter 12A in a way that –

- (a) maintains financial stability;
- (b) ensures that the critical functions performed by the designated institution continue to be performed; and
- (c) in the case of a bank, protects the interests of depositors;

‘payment system’ means a set of instruments, procedures, and rules for the transfer of funds between or among participants; the system includes the participants and the entity operating the arrangement. Payment systems are typically based on an agreement between or among participants and the operator of the arrangement, and the transfer of funds is effected using an agreed-upon operational infrastructure;

‘pre-existing contract’ means a covered contract that is already in place prior to the coming into force of the provisions relating to stays on early termination rights and moratoria on contracts of designated institutions in resolution;

‘SARB’ means the South African Reserve Bank in its capacity as the resolution authority in terms section 166A of the Act; and

‘termination right’ means, in relation to covered contracts, the right to –

- (a) terminate, accelerate, close out, set off or net obligations, or any similar right that suspends, modifies, or extinguishes an obligation of a party to such a contract; or
- (b) to prevent an obligation from arising under such a contract.

4. Roles and responsibilities

4.1 A designated institution in resolution must continue to perform its obligations in terms of its contracts as failure to do so gives rise to the default provisions in the relevant contracts.

4.2 The governing body is ultimately responsible for ensuring that a designated institution has adequate measures in place to facilitate compliance with the principles and requirements as set out in this Standard on a continuous basis.

5. Application

5.1 This Standard provides clarity on the principle contained in the Act and ensures that the South African resolution framework complies with international best practices by stipulating that the moratoria provided for under section 166R of the Act will not exceed forty-eight (48) hours.

5.2 The Standard applies to all designated institutions as defined and must be read in conjunction with the Act and relevant financial sector laws.

5.3 Central banks, market infrastructures as well as payment systems as defined in the Principles for Financial Market Infrastructures are excluded from the requirements set out herein.

5.4 This Standard applies to early termination rights that arise only by reason of entry of a designated institution into resolution or in connection with the use by the SARB of its resolution powers in relation to a designated institution.

5.5 This Standard applies to 'covered contracts' entered into by a designated institution. For purposes of this Standard, 'covered contracts' mean contracts that:

- (a) are governed under foreign law; and
- (b) contain provisions for early termination rights.

5.6 Further to paragraph 5.4 above, this Standard applies to the following specific financial contracts entered into by a designated institution, which contracts meet the definition of a covered contract:

- (a) Securities contracts, including:
 - (i) contracts for the purchase, sale or loan of a security, a group or index of securities;
 - (ii) options on a security or group or index of securities; and
 - (iii) repurchase or reverse repurchase transactions on any such security, group or index.
- (b) Commodities contracts, including:
 - (i) contracts for the purchase, sale or loan of a commodity or group or index of commodities for future delivery;
 - (ii) options on a commodity or group or index of commodities; and
 - (iii) repurchase or reverse repurchase transactions on any such commodity, group or index.
- (c) Futures and forwards contracts, including contracts for the purchase, sale or transfer of a commodity or property of any other description, service, right or interest for a specified price at a future date.
- (d) Swap contracts, including:

- (i) swaps and options relating to interest rates; spot or other foreign exchange contracts; currency; an equity index or equity; a debt index or debt; commodity indices or commodities; weather; emissions or inflation;
 - (ii) total return, credit spread or credit swaps; and
 - (iii) any contracts or transactions that are similar to an agreement referred to under subparagraphs (i) or (ii) above, which are the subject of recurrent dealing in the swaps or derivatives markets.
- (e) Master agreements entered into in respect of any of the contracts referred to under sub-paragraphs (a) to (d) above.

5.7 Section 166L of the Act provides that the placing or intention to place a designated institution in resolution, and the taking or proposal to take a resolution action in relation to a designated institution does not give rise to early termination rights of counterparties.

5.8 Section 166L of the Act does not absolve a designated institution in resolution from performing any of its other contractual obligations, including payment and delivery obligations.

5.9 Notwithstanding paragraph 5.8 above, in certain situations it may be necessary, for orderly resolution, to allow the designated institution to, temporarily, not perform on some of its obligations in terms of its covered contracts without counterparties terminating the contracts.

6. Contractual recognition in contracts governed by foreign law

6.1 To complement the provisions under section 166L of the Act, designated institutions must adopt a contractual recognition approach for the implementation of temporary stays in resolution.

7. Contractual recognition requirements

7.1 Designated institutions must ensure that the terms and conditions of covered contracts that they enter into contain provisions to the effect that parties to such contracts agree to be bound by resolution stays on the exercise of early termination rights that may be imposed by the SARB.

- 7.2 Designated institutions must ensure that any early termination provisions in covered contracts do not provide rights to a counterparty to terminate a contract in the event of a decision or proposal by the SARB to place the designated institution in resolution.
- 7.3 Designated institutions must not amend existing contracts, or make provision in contracts it enters into, that gives, or may purport to give, a right to a third party that aims to circumvent the operation of section 166L.
- 7.4 A designated institution must undertake an independent review of the legal enforceability of its contractual recognition provisions at least annually.
- 7.5 The review referred to under paragraph 7.4 above must be carried out by a designated institution's legal function, or any other suitably qualified independent third party.
- 7.6 The adoption and implementation of a contractual recognition of stay provisions must be subject to an appropriate governance process with clearly defined roles and responsibilities for a designated institution's board of directors, management as well as the relevant oversight functions.

8. Governance requirements

- 8.1 Designated institutions must have a clear understanding of their exposures in respect of their covered contracts as well as those entered into by entities within the designated institution's group of companies and/or that are guaranteed or otherwise supported by those companies or the designated institution concerned. This includes information about the status of compliance with the temporary stay provisions on an aggregate basis, as well as at an entity level for each of the relevant entities in the designated institution's group of companies.
- 8.2 Designated institutions must have in place internal system capabilities to maintain a detailed record of covered contracts they have entered into (or guaranteed or otherwise supported), and to be able to present information on these contracts in a timely manner.

8.3 The capabilities referred to under paragraph 8.2 must be established as part of resolution planning obligations, irrespective of whether an actual resolution is foreseen, and should be embedded in designated institutions' internal governance framework and risk management processes.

8.4 The detailed record of covered contracts referred to under paragraph 8.2 above should be kept at an individual entity level and should include, but not be limited to, the following key feature:

- (a) governing law;
- (b) covered contract type;
- (c) details of the termination right provisions;
- (d) counterparty type;
- (e) counterparty's jurisdiction of incorporation; and
- (f) mark-to-market values and notional amounts by number of trades and agreements.

9. General compliance requirements

9.1 A designated institution must have in place clearly defined policies, procedures and documented practices for monitoring and ensuring compliance with the requirements in this Standard.

9.2 The SARB will, on an ongoing basis, assess a designated institution's compliance with the requirements herein and failure by a designated institution to comply with this Standard may result in one or more of the following actions being taken by the Prudential Authority against such designated institution:

- (a) an increase in a designated institution's Flac instrument holdings, where applicable;
- (b) an increase in a designated institution's required regulatory capital; and
- (c) an acceleration in the triggering of resolution.

10. Reporting requirements

- 10.1 A designated institution must report in the form, manner and period determined by the Prudential Authority on compliance with requirements relating to this Standard.
- 10.2 A designated institution must on request by the Prudential Authority report to the Prudential Authority, the extent to which the covered contracts it has entered into comply with the stay requirements outlined in this Standard.
- 10.3 The reporting referred to under paragraphs 10.1 and 10.2 above must at a minimum, contain a detailed categorisation of covered contracts including for the relevant entities within its group of companies, under the following broad categories:
- (a) compliant covered contracts;
 - (b) non-compliant covered contracts; and
 - (c) pre-existing covered contracts.
- 10.4 The SARB may request further details on specific contracts during the bilateral resolution planning work programme with designated institutions, on an ad hoc basis.
- 10.5 To confirm that the contractual recognition provisions implemented by the designated institution are consistent with the SARB's resolution objectives, a designated institution must, on request by the SARB, and at its own cost, obtain a legal opinion on the legal enforceability or effectiveness of the contractual recognition provisions on termination rights from a suitably qualified independent third party agreed to by the SARB.