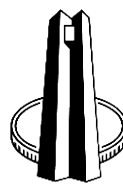




Financial Sector
Conduct Authority



SOUTH AFRICAN RESERVE BANK
Prudential Authority

File ref no. 15/8

JOINT STANDARD 2 OF 2020

FINANCIAL SECTOR REGULATION ACT, 2017

**MARGIN REQUIREMENTS FOR NON-CENTRALLY CLEARED OVER THE COUNTER
DERIVATIVE TRANSACTIONS**

The Financial Sector Conduct Authority and the Prudential Authority, acting with the concurrence of the Reserve Bank, hereby, under section 107, read with sections 106(1)(a), 106(2)(a) and (e) and 109(2), of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017), publish the margin requirements for non-centrally cleared over the counter derivative transactions as set out in the Joint Standard.

FINANCIAL SECTOR CONDUCT AUTHORITY

PRUDENTIAL AUTHORITY

Date of publication: 2 June 2020

SCHEDULE

Financial Sector Regulation Act, 2017

Joint Standard 2 of 2020

Margin requirements for non-centrally cleared over the counter derivative transactions

As amended by:

Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC
derivative transactions, 2023
[with effect from 09 June 2023]]

1. Definitions

In this Joint Standard, **“the Act”** means the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017), and any word or expression to which a meaning has been assigned in the Act bears the meaning so assigned to it, and unless the context indicates otherwise-

“authorised user” means an authorised user as defined in the Financial Markets Act;

“Authorities” means the Financial Sector Conduct Authority and the Prudential Authority;

“central counterparty” means a licensed central counterparty as defined in the Financial Markets Act;

“clearing house” means a licensed clearing house as defined in the Financial Markets Act;

“clearing member” means a clearing member as defined in the Financial Markets Act;

“counterparty” means the following:

- (a) an authorised user;
- (b) a bank, bank controlling company or branch as defined in terms of the Banks Act;
- (c) a financial services provider authorised to provide financial services in derivative instruments¹ as contemplated in the Financial Advisory Intermediary Services Act;
- (d) an insurer licensed or deemed to be licensed to conduct life insurance business in terms of the Insurance Act;
- (e) an insurer licensed or deemed to be licensed to conduct non-life insurance business in terms of the Insurance Act;
- (f) an investment fund;
- (g) a provider;

¹ The FAIS Act definition of financial products includes securities as defined in the FMA, which definition includes derivative instruments.

- (h) any other person as may be determined by the Financial Sector Conduct Authority, with the concurrence of the Prudential Authority, to be a counterparty;

[Paragraph (h) of the definition of “counterparty” substituted by paragraph 2(1) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

“FMA Regulations” means the Financial Markets Act Regulations as published in Government Gazette No. 41433 on 9 February 2018;

“foreign counterparty” means a person outside the Republic of South Africa who-

- (a) is authorised by a supervisory authority to perform a service or services similar to one of more of the services referred to in the definition of a provider or the services performed by an authorised user; or
- (b) is registered, licensed, recognised, approved or otherwise authorised to conduct the business of a bank or of an institution referred to in paragraphs (d), (e), or (f), of the definition of “counterparty” by a supervisory authority with functions similar to those of the Financial Sector Conduct Authority or the Prudential Authority referred to in the legislation listed in paragraph (b), (d), or (e) of the definition of “counterparty” or the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002);

“group” means a group of companies as defined in the Companies Act;

“Insurance Act” means the Insurance Act, 2017 (Act No. 18 of 2017);

“Investment fund” includes a portfolio of a collective investment scheme administered by a manager registered in terms of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002) and a private equity fund;

“netting set” means a group of derivative transactions between a provider and a counterparty or foreign counterparty that are subject to a single legally enforceable bilateral netting agreement;

“OTC derivative” means an OTC derivative as defined in the FMA Regulations;

“private equity fund” means a managed pool of capital that-

- (a) has as its principal business the making of equity, equity orientated or equity related investments primarily in unlisted companies or ventures to earn income or capital gains;
- (b) is managed or advised by a member of the South African Venture Capital and Private Equity Association or other equivalent private equity and venture capital industry body; and
- (c) is not open or offered to the public as an investment;

“provider” means an authorised OTC derivative provider as defined in the FMA Regulations; and

“**sovereign**” means the central government and includes the central government in the Republic of South Africa as constituted by the national sphere of government, excluding any national public entity or national government business enterprise as defined in the Public Finance Management Act, 1999 (Act No.1 of 1990).

2. Application and exclusions

2.1 General application

- (1) The Joint Standard applies to -
 - (a) a provider entering into non-centrally cleared OTC derivative transactions with a counterparty or a foreign counterparty; and
 - (b) for purposes of paragraph 6A, a financial institution that is a counterparty.

[Paragraph 2.1(1) amended by paragraph 2(2) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (2) The Joint Standard does not apply to:
 - (a) sovereigns;
 - (b) central banks;
 - (c) multilateral development banks;
 - (d) the Bank for International Settlements;
 - (e) transactions such as repurchase agreements and security lending transactions that are not derivatives but share some attributes with derivative instruments; and
 - (f) indirectly cleared OTC derivative transactions that are intermediated through a clearing member on behalf of a non-member client, if-
 - (i) the non-member client is subject to the margin requirements of the relevant clearing house; or
 - (ii) the non-member client provides margin, consistent with the margin requirements of the relevant corresponding clearing house.
- (3) The margin requirements set out in this Joint Standard apply to all non-centrally cleared OTC derivative transactions, including intra-group and cross-border transactions as contemplated in paragraph 2.2 and 2.3 respectively, after the thresholds set out in paragraphs 4.2 or 5(3) are met.
- (4) Physically settled foreign exchange forward contracts and foreign exchange swaps are excluded from the initial and variation margin requirements.
- (5) In the case of cross-currency swaps, the initial margin requirements do not apply to any fixed physically settled foreign exchange transaction associated with the exchange of principal, that is, for a cross-currency swap, any payment associated with the exchange

of principal in respect of a fixed physically settled foreign exchange transaction, which has the same characteristics as a foreign exchange forward contract, is excluded from the requirements for initial margin, provided that-

- (a) the provider must ensure that all other risks that affect the cross-currency swap transaction are duly considered in the calculation of the initial margin amount, that is, all payments or cash flows, including interest, that occur during the life of the swap, other than a payment associated with the exchange of principal in respect of a fixed physically settled foreign exchange transaction, shall be subject to the relevant specified requirements for initial margin; and
- (b) the variation margin requirements set out in this Joint Standard apply to all relevant components of a cross-currency swap transaction.

2.2 Treatment of intra-group transactions

- (1) Subject to sub-paragraphs (2) and (3), the margin requirements set out in this Joint Standard do not apply to non-centrally cleared OTC derivative transactions entered into between a provider and a counterparty or foreign counterparty in the same group.
- (2) Non-centrally cleared OTC derivative transactions between a provider and a counterparty or foreign counterparty in the same group are not subject to any margin requirements as set out in this Joint Standard, provided that –
 - (a) the aggregate outstanding gross notional amount of the non-centrally cleared OTC derivative transactions between the provider and the counterparty or foreign counterparty in the group is below R100 billion at the close of business on each relevant day, or such alternative threshold as may be determined by the Authorities from time to time;
 - (b) both parties to the transaction are subject to appropriate centralised risk evaluation, measurement and control procedures;
 - (c) the risk management procedures of both parties to the transactions are adequately sound, robust and consistent with the level of complexity of the respective derivative transactions between them; and
 - (d) the parties to the transactions comply with any further conditions as may be specified in writing by the Authorities.
- (3) Despite sub-paragraph (2), the Authorities may require a provider to exchange variation margin or post or collect initial margin with a counterparty or foreign counterparty in the same group, when deemed appropriate by the Authorities.

2.3 Cross-border transactions

- (1) When a provider enters into a non-centrally cleared OTC derivative transaction with a foreign counterparty, the provider is deemed to comply with the Joint Standard provided that the provider has the necessary documentary evidence in place to satisfy itself that-
 - (a) the relevant foreign jurisdiction has implemented margin requirements based on the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions (BCBS-IOSCO) Margin Requirements for Non-Centrally Cleared Derivatives Framework;
 - (b) the foreign counterparty is directly subject to the margin requirements of the foreign jurisdiction; and
 - (c) the provider is required to comply with, or is subject to, the margin requirements in the foreign jurisdiction.
- (2) The Authorities may require the provider to furnish the Authorities with the documentary evidence, or such further information as the Authorities may deem necessary.
- (3)
 - (a) A provider that enters into an OTC derivative transaction with a foreign counterparty in a foreign jurisdiction of which the relevant legal framework does not permit or recognise the enforceability of a netting agreement upon the insolvency of the counterparty or the enforceability of a collateral agreement upon the default of the counterparty ("non-netting jurisdictions"), is not required to post or collect initial margin or exchange variation margin in respect of such transaction if-
 - (i) the aggregate outstanding gross notional amount of transactions between the provider and the foreign counterparty do not exceed 2.5% of the total portfolio of derivatives contracts of the provider on a consolidated basis; and
 - (ii) a legal opinion confirms that the netting agreement or the exchange of collateral is not legally enforceable at all times.
 - (b) If the aggregate outstanding gross notional amount of transactions between the provider and the foreign counterparty is above the threshold set out sub-paragraph (3)(a)(i), the provider must obtain the prior written approval of the Financial Sector Conduct Authority, acting with the concurrence of the Prudential Authority, to proceed with any further transactions, provided that the provider has submitted a legal opinion to the Authorities confirming that the netting agreement or the collateral agreement between the provider and the foreign counterparty may not be enforceable in the foreign jurisdiction and any other information as may be requested by the Authorities.
 - (c) The legal opinion referred to in sub-paragraph (3) must be in written form and must be obtained from an external legal counsel but may include jurisdictional

opinions obtained on an industry-wide basis by recognised industry associations from external independent legal counsel.

- (d) The Financial Sector Conduct Authority, with the concurrence of the Prudential Authority, may grant approval to the provider to proceed with further transactions between the provider and the foreign counterparty, subject to such conditions as may be further specified in writing by the Financial Sector Conduct Authority, including a requirement to post or collect initial margin or exchange variation margin.
- (e) In all cases as outlined in subparagraphs (a) and (b) above, the provider must put in place appropriate internal limits and risk management policies and procedures commensurate to its risk appetite to monitor and control the risks of relevant exposures arising from transactions in non-netting jurisdictions.

3. General requirements

- (1) Subject to paragraph 2, in order to mitigate the potential systemic risk that may arise from, and to promote effective and sound risk management in respect of, a provider's transactions in non-centrally cleared OTC derivative transactions, a provider must -
 - (a) based on the relevant amount of counterparty credit risk exposure arising from its non-centrally cleared OTC derivative transactions, calculate and exchange-
 - (i) initial margin in accordance with the relevant requirements specified in paragraph 4; and
 - (ii) variation margin in accordance with the relevant requirements specified in paragraph 5;
 - (b) have in place sufficiently robust processes, procedures and board-approved policies in respect of the provider's non-centrally cleared OTC derivative transactions, to ensure, among other things, that-
 - (i) all relevant transactions between the provider and counterparty are subject to and comply with all the relevant requirements specified in the legal and regulatory frameworks of each relevant jurisdiction;
 - (ii) subject to sub-paragraph 2.3(3), all relevant netting agreements are effective under the laws of the relevant jurisdictions, and supported by periodically updated legal opinions;
 - (iii) subject to sub-paragraph 2.3(3), all relevant collateral arrangements in place are effective under the relevant laws and are supported by periodically updated legal opinions;
 - (iv) the provider that engages in OTC derivative transactions, exchange initial and variation margin on a bilateral basis or to a third-party custodian, where

applicable, as envisaged in and in accordance with the relevant requirements specified in this Joint Standard;

- (v) procyclicality impacts are appropriately mitigated, that is-
 - (aa) large discrete calls for additional initial margin due to “cliff-edge” triggers, for example, are discouraged; and
 - (bb) margin levels are sufficiently conservative, even during periods of low market volatility;
 - (vi) initial margin is provided and collected by no later than the business day following the execution of a non-centrally cleared OTC derivative transaction, and thereafter collected on a routine and consistent basis upon changes in the measured potential future exposure;
 - (vii) the build-up of any additional initial margin is gradual, and managed over time;
 - (viii) in case of variation margin-
 - (aa) the full amount necessary to fully collateralise the relevant mark-to-market exposure of the OTC derivative transaction is exchanged;
 - (bb) the relevant amount of variation margin for OTC derivative transactions, subject to a single, legally enforceable netting agreement, is calculated and exchanged on a daily basis;
 - (ix) the provider complies with the relevant requirements specified in paragraph 6, which relates to eligible collateral.
- (2) A provider must have in place rigorous and robust dispute resolution procedures with its relevant counterparties involved in non-centrally cleared OTC derivative transactions, before the onset of any relevant transaction, provided that, as a minimum-
- (a) in order to reduce the risk of any potential dispute, the provider must ensure, for example, that the specific method and parameters that will be used to calculate initial margin are agreed and recorded at the onset of all relevant transactions;
 - (b) whenever a margin dispute or dispute over the value of eligible collateral arises, the provider must make all necessary, reasonable and appropriate efforts, including the timely initiation of dispute resolution protocols, to resolve the dispute and exchange the relevant required amount of initial or variation margin in a timely manner.
- (3) All margin transfers as contemplated in this Joint Standard may be subject to a minimum transfer amount of which the aggregate or sum of the initial margin and variation margin does not exceed R5 million.

4. Initial margin

4.1 General

- (1) Initial margin aims to protect the provider and the counterparty from the potential future exposure that may arise from future changes in the mark-to-market value of the derivative contract during the time it takes to close out and replace the position in the event that one or more of the counterparties to the contract default.
- (2) The amount of initial margin reflects the size of the potential future exposure and depends on a variety of factors, including how often the contract is revalued and variation margin exchanged, the volatility of the underlying instrument, and the expected duration of the contract closeout and replacement period, and may change over time, particularly where it is calculated on a portfolio basis and transactions are added to or removed from the portfolio on a continuous basis.
- (3)
 - (a) In order to sufficiently protect market participants with large gross derivatives exposures to each other arising from non-centrally cleared OTC derivative transactions from counterparty default or a counterparty becoming subject to an insolvency proceeding, the provider and counterparty must on a bilateral basis, based on the relevant gross amounts, that is, without any netting of amounts collected or to be collected by each relevant person, calculate and exchange initial margin.
 - (b) The requirement to calculate and exchange initial margin on a bilateral basis must in all cases be subject to an initial margin threshold amount, not to exceed R500 million.
 - (c) The threshold amount referred in sub-paragraph 4.1(3)(b) relates to the aggregate amount of all relevant transactions in non-centrally cleared OTC derivatives between the provider on a consolidated basis and the relevant consolidated counterparty group.

[Paragraph 4.1(3)(c) amended by paragraph 2(3)(a) of Joint Standard Amendment 1 of 2023: Amendments to: Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (d) An investment fund must for purposes of this Joint Standard be regarded as a distinct entity that has to be treated separately when applying the threshold amount as long as it is proven to the satisfaction of the Financial Sector Conduct Authority that the fund is a distinct legal entity that is not collateralised by, or otherwise guaranteed or supported by, another investment fund in the event of an insolvency proceeding.

4.2 Phasing in of initial margin requirements

- (1) From the effective date of this Joint Standard to 31 August 2021, any provider belonging to a group of which the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2020 exceeded R30 trillion must comply with the margin requirements when transacting with a counterparty belonging to a group that also meets the condition related to the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2020 exceeding R30 trillion.

[Paragraph 4.2(1) amended by paragraph 2(3)(b) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (2) From 1 September 2021 to 31 August 2022, a provider belonging to a group of which the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2021 exceeded R23 trillion, must comply with the margin requirements when transacting with a counterparty belonging to a group that also meets the condition related to the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2021 exceeding R23 trillion.

[Paragraph 4.2(2) amended by paragraph 2(3)(c) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (3) From 1 September 2023 to 31 August 2024, a provider belonging to a group of which the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2023 exceeded R15 trillion must comply with the margin requirements when transacting with a counterparty belonging to a group that also meets the condition related to the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2023 exceeding R15 trillion.

[Paragraph 4.2(3) amended by paragraph 2(3)(d) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (4) From 1 September 2024 to 31 August 2025, a provider belonging to a group of which the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2024 exceeded R8 trillion must comply with the margin requirements when transacting with a counterparty belonging to a group that also meets the condition related to the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2024 exceeding R8 trillion.

[Paragraph 4.2(4) amended by paragraph 2(3)(e) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (5) On a permanent basis, that is from 1 September 2025, onwards, any provider belonging to a group of which the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May 2025 exceeded R100 billion must comply with the margin requirements during the one-year period from 1 September of that year to 31 August of the following the year when transacting with a counterparty belonging to a group that also meet this condition, provided that any provider or counterparty that belonging to a group of which the aggregate month-end average gross notional amount of OTC derivatives for March, April, and May of the year is less than R100 billion shall not be subject to the initial margin requirements envisaged in this Joint Standard.

[Paragraph 4.2(5) amended by paragraph 2(3)(f) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (6) For the purposes of calculating the group aggregate month-end average gross notional amount referred to in sub-paragraphs (1) to (5) to determine whether a provider or counterparty is subject to the initial margin requirements specified in this paragraph, all of the relevant group's transactions in OTC derivative instruments, including any physically settled foreign exchange forwards and swaps, must be included.
- (7) The requirement to calculate and exchange initial margin on a bilateral basis applies to all new contracts entered into during the relevant periods envisaged in sub-paragraphs (1) to (5), that is, the initial margin requirements specified in this Joint Standard do not apply to existing derivatives contracts up to the relevant specified point, provided that-
- (a) bona fide amendments to existing derivatives contracts shall for purposes of this Joint Standard not be regarded as a new derivatives contract;
 - (b) any amendment to a contract that is intended to extend an existing derivatives contract to avoid margin requirements shall for purposes of this Joint Standard be considered a new derivatives contract.
- (8) When the initial margin amount to be exchanged between the provider and counterparty -
- (a) is less than the threshold amount of R500 million, the provider may, at its discretion, decide whether or not to collect the initial margin amount;
 - (b) is equal to or exceeds the threshold amount of R500 million, the provider must

collect at least the difference between the relevant required initial margin amount and the threshold amount, that is when the relevant required initial margin amount for a particular OTC derivatives portfolio, for example, is R550 million, the provider must, as a minimum, collect R50 million initial margin from its relevant counterparty, or such a higher amount as the provider may decide, in accordance with the provider's relevant risk management principles and policies approved by the board or equivalent structure.

4.3 Collateral

- (1) Any cash or non-cash collateral collected as initial margin may be rehypothecated, re-pledged or re-used (collectively referred to as re-hypothecated, unless specifically otherwise stated) only once by the initial margin collector, in accordance with the relevant requirements and conditions specified below:
 - (a) cash or non-cash collateral that is collected as initial margin may be rehypothecated to a third party only for purposes of hedging the initial margin collector's derivatives position arising from derivatives transactions for which initial margin was collected, provided that -
 - (i) all the relevant transactions, agreements or arrangements must be subject to conditions that protect the initial margin provider's rights in the collateral, to the extent permitted by relevant national legislation;
 - (ii) for the purposes of this paragraph (1), the initial margin provider Includes only buy-side financial entities as well as non-financial entities, but does not Include entitles that regularly hold themselves out as making a market in derivatives, routinely quote bid and offer prices on derivatives contracts and routinely respond to requests for bid or offer prices on derivatives contracts;
 - (b) in all cases, once initial margin collected has been rehypothecated to a third party in accordance with the relevant requirements specified in this Joint Standard, no further re-hypothecation of the initial margin by the third party is permitted;
 - (c) when the initial margin collector rehypothecates initial margin, the agreement between the initial margin collector and the third party recipient of the collateral must explicitly prohibit the third party from rehypothecating the collateral;
 - (d) in all cases, the initial margin collected may be rehypothecated as set out in

this Joint Standard only if the following conditions are met:

- (i) the initial margin provider, must, as part of its contractual agreement with the initial margin collector, and after disclosure by the initial margin collector of-
 - (aa) its right not to permit rehypothecation; and
 - (bb) the risks associated with the nature of the initial margin provider's claim to the rehypothecated collateral in the event of the insolvency of the initial margin collector or the third party, give express consent in writing to the re-hypothecation of its collateral;
- (ii) the initial margin collector must be subject to regulation of liquidity risk;
- (iii) the initial margin collected must be treated as the initial margin provider's asset, and must be segregated from the initial margin collector's proprietary assets, until rehypothecated, provided that once rehypothecated, the third party must segregate it from the third party's proprietary assets;
- (e) in all cases, the collateral of counterparties that have consented to the rehypothecation of their collateral must be segregated from that of counterparties that have not consented;
- (f) when initial margin has been individually segregated and subsequently rehypothecated, the initial margin collector must require and obtain written confirmation from the third party that the collateral has been segregated from the assets of the third party's other customers, counterparties and its own proprietary assets;
- (g) legally enforceable protection must be given to the initial margin provider from the risk of loss of initial margin In the event that either the Initial margin collector or the third party become insolvent:
- (h) when collateral is rehypothecated, the initial margin collector must -
 - (i) notify the Initial margin provider of that fact;
 - (ii) upon request by the initial margin provider and where the initial margin provider has opted for individual segregation, notify the initial margin provider of the amount of cash collateral end the value of non-cash collateral that has been re-hypothecated;
- (i) the initial margin collector must have in place sufficiently robust processes

and procedures to-

- (i) ensure that collateral is only rehypothecated to, and held by, an entity that is regulated in a Jurisdiction that complies with all the specific conditions specified in this paragraph, and in which the specific conditions may be duly enforced by the initial margin collector;
 - (ii) ensure at all times that the initial margin provider and the third party are not within the same group;
 - (iii) demonstrate to the satisfaction of the Prudential Authority that appropriate records are maintained by the initial margin collector and the relevant third party to ensure compliance with all the relevant conditions specified in this paragraph;
 - (iv) report the level and volume of rehypothecation to the Prudential Authority whenever required or requested.
- (2) (a) Initial margin must be held in such a manner that it is immediately available to the person that collected the initial margin in the event of the counterparty's default; and must be subject to arrangements under applicable law that fully protect the person that posted the relevant amount, to the extent possible. In the event that an Insolvency proceeding is commenced against the person that collected the amount.
- (b) The collected collateral must be segregated from the initial margin collector's proprietary assets.
- (c) The initial margin collector must give the initial margin provider the option to segregate the collateral that it posts from the assets of all the initial margin collector's other customers and counterparties (i.e. individual segregation).

4.4 Alternative measurement methodologies

- (1) For the calculation of the relevant required amount of initial margin related to OTC derivative transactions, a provider must, at its discretion, use one of the alternative methodologies specified below:
- (a) the less risk sensitive standardised margin schedule approach specified in paragraph 4.5; or
 - (b) subject to the prior written approval of, and to such conditions as may be imposed in writing by the Financial Sector Conduct Authority, with the concurrence of the Prudential Authority, the more risk sensitive quantitative portfolio margin model approach specified in paragraph 4.6.

- (2) A provider must consistently apply one of the methodologies referred to in subparagraph (1) over time, that is the provider -
- (a) must consistently apply either the standardised schedule-based initial margin approach or the quantitative portfolio margin model approach, over time, in respect of all derivative transactions within the same well-defined asset class;
 - (b) may not switch between model-based and standardised schedule-based margin calculations.
- (3) A provider need not restrict itself to a model-based approach or to a standardised schedule-based approach for the entirety of all its derivatives activities, that is, the provider may use a model-based initial margin calculation for one class of derivatives in which it commonly deals and a standardised schedule-based initial margin calculation in the case of a seldom traded derivative asset class.

4.5 Standardised method

A provider that wishes to adopt the standardised initial margin schedule approach for the calculation of the relevant required amount of initial margin related to the potential future exposure of all relevant non-centrally cleared OTC derivatives-

- (a) must firstly calculate the relevant required gross initial margin amount by multiplying the relevant gross notional exposure of each relevant derivative contract with the initial margin rates specified in Table 1 below:

Table 1

Asset class	Initial margin requirement (% of notional exposure)
Credit:	
0–2 year duration	2%
2–5 year duration	5%
5+ year duration	10%
Commodity	15%
Equity	15%
Foreign exchange	6%
Interest rate:	
0–2 year duration	1%
2–5 year duration	2%
5+ year duration	4%
Other	15%

- (b) must directly following the calculation of the relevant gross initial margin amount envisaged above, adjust the gross initial margin amount by the net-to-gross ratio (NGR) pertaining to all derivative instruments in the relevant legally enforceable netting set, in accordance with the formula specified below, or such formula as may be specified from time to time by the Prudential Authority:

$$\text{Net standardised initial margin} = 0.4 * \text{Gross initial margin} + 0.6 * \text{NGR} * \text{Gross initial margin}$$

where:

NGR is the ratio of the net current replacement cost to gross current replacement cost for transactions subject to the relevant legally enforceable netting agreement, where the net replacement cost is the maximum of the zero and the sum of current market values of all OTC derivative transaction in the netting set;

- (c) may consider an inflation swap contract, which transfers inflation risk between the relevant counterparties, as part of the interest rate asset class for purposes of calculating the relevant initial margin requirement;
- (d) must finally calculate the total required amount of initial margin by aggregating the calculated net standardised initial margin amounts of all derivative instruments in the provider's relevant portfolio of derivative contracts.

4.6 Quantitative portfolio margin model

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

- (a) obtain the prior written approval of and comply with such conditions as may be specified in writing by the Prudential Authority, with the concurrence of the Financial Sector Conduct Authority, in addition to the relevant requirements specified in this Joint Standard;
- (b) implement and maintain a sufficiently robust quantitative portfolio margin model, which model may either be developed internally or sourced from relevant counterparties or third-party vendors, that calculates an extreme but plausible estimate of an increase in the value of the instrument that is consistent with a one-tailed 99% confidence interval over a 10-day horizon, based on historical data not exceeding five years, provided that-

- (i) the 10-day horizon applies only when variation margin is exchanged on a daily basis;
- (ii) when variation margin is exchanged less frequently than on a daily basis, the minimum horizon must be equal to 10 days plus the number of days in between variation margin exchanges;
- (iii) the threshold amount of R500 million specified in this Joint Standard must in all cases be unrelated to the frequency with which variation margin is exchanged;
- (iv) the data must contain a period of significant financial stress which must be identified and applied separately for each relevant broad asset class for which the relevant required portfolio margining amount is calculated;
- (v) when the provider wishes to use a third party-provided model for the calculation of initial margin, the provider must clearly state in its application to the Prudential Authority each relevant jurisdiction and each relevant institution in respect of which the provider wishes to use that model, that is, there shall be no presumption that approval by any supervisor in the case of one or more institutions implies approval for a wider set of jurisdictions or institutions;
- (vi) the quantitative initial margin model must be subject to a robust internal governance process that continuously-
 - (aa) ensures that the model produces appropriately risk-sensitive assessments of potential future exposure;
 - (bb) assesses the value of the model's risk assessments;
 - (cc) tests the model's assessments against realised data and experience;
 - (dd) validates the applicability of the model to the derivatives for which it is being used;
 - (ee) takes into account the complexity of the products covered, such as barrier options or other more complex structures;
- (vii) the quantitative initial margin model-
 - (aa) may account for risk on a portfolio basis;
 - (bb) may consider all of the relevant derivatives that are approved for model use and that are subject to a single legally enforceable netting agreement, that is, derivative transactions between the provider and a relevant counterparty that are not subject to the same legally enforceable netting agreement shall not be included in the same initial margin calculation;
 - (cc) may, subject to the explicit prior written approval of and such conditions as may be specified in writing by the Prudential Authority, with the concurrence of the Financial Sector Conduct Authority, account for diversification, hedging and risk offsets within well-defined asset classes, such as

currency/rates, equity, credit, or commodities, but in no case across such asset classes, provided that-

- (AA) in all cases, the relevant instruments must be covered by the same legally enforceable netting agreement;
- (BB) the relevant initial margin requirement for currency and interest rate derivative instruments may be calculated on a portfolio basis, that is, the relevant initial margin requirement for an interest rate swap and a currency option, for example, may be calculated on a portfolio basis, as part of a single asset class; and
- (CC) an inflation swap contract, which transfers inflation risk between the relevant counterparties, may be considered as part of the currency/rates asset class;
- (dd) must calculate the relevant required initial margin for derivatives in distinct asset classes without any regard to derivatives in other asset classes, that is, the initial margin requirement on a credit derivative instrument, for example, must be calculated separately from the initial margin requirement on a commodity derivative, and the total initial margin requirement for the provider's derivative portfolio must be equal to the sum of the relevant individually calculated initial margin amounts;
- (viii) the data within the identified period referred to in paragraph 4.6(b) must be equally weighted for calibration purposes.

[Paragraph 4.6(b) amended by paragraph 2(3)(g) – (i) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

5. Variation margin

- (1) Variation margin aims to protect the provider and the counterparty from the current exposure that arises from changes in the mark-to-market value of the contract after the transaction between the provider and the counterparty has been executed.
- (2) The amount of variation margin reflects the size of the current exposure and depends on the mark-to-market value of the derivative contract at any point in time, and as such changes over time.
- (3) A provider that engages in transactions in non-centrally cleared OTC derivative transactions with a counterparty must on a daily and bilateral basis calculate and exchange the relevant amount of variation margin necessary to fully collateralise the relevant mark-to-market exposure in respect of the non-centrally cleared OTC derivatives, without the application of any threshold amount, provided that-
 - (a) from the effective date of this Joint Standard, any provider belonging to a group

of which the aggregate month-end average gross notional amount of OTC derivative instruments for March, April and May of 2020 exceeded R30 trillion must exchange variation margin when transacting with a counterparty belonging to a group that also meets the condition related to the aggregate month-end average gross notional amount of OTC derivative instruments for March, April and May of 2020 exceeding R30 trillion, provided that-

- (i) the requirement to calculate and exchange variation margin between the provider and counterparty only applies to new contracts entered into after the effective date of this Joint Standard; and
 - (ii) the exchange of variation margin on all other relevant contracts must be subject to bilateral agreement;
- (b) subject to sub-paragraph (a), from 6 months after the effective date of this Joint Standard, a provider that engages in transactions in non-centrally cleared OTC derivative transactions with a counterparty must exchange variation margin in accordance with the relevant requirements specified in this Joint Standard, provided that-
 - (i) the requirement to exchange variation margin only applies to new contracts entered into after 6 months from the effective date of this Joint Standard; and
 - (ii) the exchange of variation margin on all other relevant contracts is subject to a bilateral agreement;
- (c) any cash and non-cash collateral collected as variation margin may be rehypothecated, re-pledged or re-used.

6. Eligible collateral

- (1) In order to ensure that assets or instruments collected or posted as collateral for purposes of initial or variation margin may be liquidated in time to generate proceeds that sufficiently protect the provider and all other relevant collecting or counterparty or persons envisaged in this Joint Standard from losses in respect of derivatives transactions not cleared through a central counterparty in the event of a counterparty default, a provider must have in place sufficiently robust processes and procedures, and board-approved policies, to ensure, among other things, that-
 - (a) the provider only accepts as collateral for purposes of initial and variation margin, eligible assets or instruments envisaged in sub-paragraph (2);
 - (b) as a minimum, the provider applies to the value of the assets or instruments collected as collateral the higher of-
 - (i) the haircuts specified in writing by the Prudential Authority, in concurrence with the Financial Sector Conduct Authority; or

- (ii) such haircut percentages as may be determined by the provider in accordance with the relevant requirements specified in sub-paragraph (5);
- (c) the provider's portfolio of eligible collateral for purposes of initial and variation margin is reasonably diversified, that is, the collateral collected must not be overly concentrated in terms of any individual issuer, issuer type or asset or instrument type;
- (d) assets or instruments collected as eligible collateral are not exposed to excessive credit, market or foreign exchange risk, including in respect of differences between the currency of the collateral asset or instruments and the currency of settlement;
- (e) when a counterparty that posted collateral to satisfy margin requirements at some point in time before the end of the derivatives contract requests that the collateral be returned for some particular reason or purpose, such collateral is substituted or exchanged for alternative collateral only if-
 - (i) both parties agree to the substitution;
 - (ii) the substitution or exchange of collateral is made on the terms applicable to the original agreement between the provider and its relevant counterparty that originally posted the collateral;
 - (iii) the alternative collateral meets all the relevant requirements specified in this Joint Standard;
 - (iv) the value of the alternative collateral, after the application of any relevant haircut, is sufficient to meet the relevant margin requirement;
- (f) collateral is in all material respects sufficient to cover the provider's relevant margin needs in a time of financial stress;
- (g) there is not a high degree of correlation between the value of the collateral and the creditworthiness of the counterparty or the value of the underlying OTC derivatives portfolio, in a manner that undermines the effectiveness of the protection offered by the margin collected, that is-
 - (i) the provider must ensure that it is duly protected against so-called "wrong way risk";
 - (ii) securities issued by the counterparty to a derivative transaction not cleared through a central counterparty, or its related entities, shall in no case constitute eligible collateral.
- (2) For the purposes of this Joint Standard, the following assets or instruments constitute eligible collateral for purposes of a provider's relevant required calculations of initial and variation margin:
 - (a) cash;

- (b) gold;
- (c) such high-quality government and central bank debt securities as may be determined by the Authorities;
- (d) such high-quality corporate bonds as may be determined by the Authorities;
- (e) such equities included in major indices as may be determined by the Authorities;
- and
- (f) such other assets or instruments as may be determined by the Authorities.

[Paragraph 6(2) amended by paragraph 2(4)(a) – (d) of Joint Standard Amendment 1 of 2023: Amendments to Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (2A) When determining eligible collateral as referred to in sub-paragraph (2)(c) – (f), the Authorities –
- (a) must publish the determination by notice on the websites of the Authorities; and
 - (b) may make the use of the specified collateral subject to such conditions as the Authorities may specify in the determination, in order to give effect to the necessary risk management, internal control requirements and assurances referred to in subparagraph (1).

[Paragraph 6(2A) inserted by paragraph 2(4)(e) of Joint Standard Amendment 1 of 2023: Amendments to: Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

- (3) Eligible collateral may be denominated in either the currency in which payment obligations under the relevant OTC derivative transaction may be made, or in highly liquid foreign currencies, and the provider must ensure that, in all cases, appropriately conservative haircuts are applied to the relevant value of the collateral to duly reflect any inherent foreign exchange risk.
- (4) A provider must in all cases apply to the value of the assets or instruments collected as collateral the higher of the haircut percentage specified in writing by the Authorities or such haircut percentage as may be determined by the provider in accordance with the relevant requirements specified in sub-paragraph (5).
- (5) The following matters related to haircuts must be applied to the value of eligible collateral:
 - (a) In order to determine the appropriate haircut to be applied to the value of eligible collateral, a provider may, at the discretion of the provider, use one of the following alternative methodologies:
 - (i) the standardised schedule-based haircut approach envisaged in sub-paragraph (d) or

- (ii) subject to the prior written approval of and such conditions as may be specified in writing by the Prudential Authority, with the concurrence of the Financial Sector conduct Authority, the internal or third-party risk-sensitive quantitative model-based haircut approach envisaged in sub-paragraph (e).
- (b) A provider must consistently apply either the standardised schedule-based haircut approach or the risk-sensitive quantitative model-based haircut approach, over time, in respect of all eligible collateral within the same well defined asset class.
- (c) A provider may not switch between model-based and standardised schedule-based haircut calculations.
- (d) A provider that wishes to adopt the schedule-based haircut approach must apply to the relevant market value of eligible collateral the relevant standardised haircut percentage specified in Table 2:

Table 2

Asset class	Haircut (% of market value)
Cash in same currency	0%
High-quality government and central bank debt securities specified in writing by the Authorities:	0.5%
- residual maturity less than or equal to one year	
- residual maturity greater than one year and less than or equal to five years	2%
- residual maturity greater than five years	4%
High-quality corporate bonds specified in writing by the Authorities:	1%
- residual maturity less than or equal to one year	
- residual maturity greater than one year and less than or equal to five years	4%
- residual maturity greater than five years	8%
Equities included in major stock indices	15%
Gold	15%

Additional (additive) haircut on asset in which the currency of the derivatives obligation differs from that of the collateral asset	8%
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- (e) A provider that wishes to adopt the risk-sensitive quantitative model-based haircut approach must-
- (i) obtain the prior written approval of and comply with such conditions as may be specified in writing by the Prudential Authority, with the concurrence of the Financial Sector Conduct Authority in addition to the relevant requirements specified in this Joint Standard;
 - (ii) implement and maintain a sufficiently robust quantitative model, which model may either be developed internally or sourced from relevant third-party vendors, that, as a minimum, determines haircuts-
 - (aa) that are risk-based and appropriately calibrated to reflect all material underlying risks that affect the value of eligible collateral, such as market price volatility, liquidity, credit risk and foreign exchange volatility, during both normal and stressed market conditions; and
 - (bb) that are sufficiently conservative to avoid procyclicality;
 - (iii) have in place sufficiently robust processes, procedures and board-approved policies to ensure that the model is at all times subject to robust internal governance standards.

6A. Reporting Requirements

- (1) A provider that enters into a non-centrally cleared OTC derivative transaction with a counterparty or a foreign counterparty, and a financial institution that is a counterparty, must report such information related to the requirements in this Joint Standard to the Authorities, as may be determined by the Authorities;
- (2) For purposes of subparagraph (1), the Authorities –
 - (a) must publish the determination by notice on the websites of the Authorities; and
 - (b) may determine the form, manner, content and period of reporting by notice on the websites of the Authorities.

[Paragraph 6A inserted by paragraph 2(5) of Joint Standard Amendment 1 of 2023: Amendments Margin Requirements for non-centrally cleared OTC derivative transactions, 2023 w.e.f. 09 June 2023]

7. Commencement and short title

This Joint Standard is called the Margin requirements for non-centrally cleared OTC derivative transactions and comes into effect on a date to be determined by the Authorities.