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FINANCE & BANKING ALERT

IN THIS **ISSUE**

OTC DERIVATIVES REGULATIONS ARE FINAL AND IN FORCE

On 9 February 2018, the Minister of Finance enacted into law the final version of the Regulations to the Financial Markets Act, 2012 (FMA Regulations). In summary, the FMA Regulations govern the provision of securities services under the Financial Markets Act, 2012 (FMA) including in respect of over-the-counter derivatives (OTC derivatives). The enactment of the FMA Regulations will come as no surprise to the financial services market (other than in respect of timing) as market participants were given the opportunity to comment on the draft versions of the FMA Regulations first in 2014, again in 2015 and once more in 2016. Following the enactment of the FMA Regulations, market participants will be required to comply with the new licensing, trade reporting and clearing requirements for OTC derivatives transactions.

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How did we get here?

In the past, the trading of OTC derivatives was a practice that was largely unregulated. Following the global financial crisis in 2008, G20 leaders noted that OTC derivatives were a significant contributor to the global financial crisis and as such the G20 leaders committed to reform the global OTC derivatives market and specifically stated that:

> "All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements."

As a member of the G20 and to comply with its commitment to the global OTC derivatives reform, South Africa began the process of developing the appropriate legislative framework, with the FMA providing the backbone for the required legislative changes. In 2014, the Minister of Finance published the first draft of the FMA Regulations which in summary, created the concept of an "OTC derivative provider" (ODP) and required all ODPs to be licensed, required all OTC derivatives transactions to be reported to a licensed trade repository and enabled the Minister of Finance to designate certain OTC derivatives contracts subject to mandatory clearing through a central counterparty. The FMA Regulations have now only been enacted almost four years after the date of first publication for comment.

What does the enactment of the FMA Regulations mean for market participants?

Now that the FMA Regulations have been enacted (with their commencement date set at the date of publication ie 9 February 2018), market participants will have to take note of the following key elements:

Licensing:

The FMA Regulations make it compulsory for all ODPs to be licensed. An ODP is " a person who as a regular feature of its business and transacting as principal-(a) originates, issues or sells OTC derivatives; or (b) makes a market in OTC derivatives". Further, the FMA Regulations define an "OTC derivative" as an unlisted derivative instrument that is executed, whether confirmed or not confirmed, excluding foreign exchange spot contracts and physically-settled commodity derivatives.

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The enactment of the FMA Regulations has got the ball rolling on the implementation of the regulation of the OTC derivatives market in South Africa and market participants should expect the relevant subordinate legislation (still currently in draft form) to be published in final form soon.

In terms of the FMA Regulations, a person conducting the business of an ODP must lodge an application for authorisation, within 6 months from the commencement date in the manner prescribed by the Authority. The Authority is currently the Financial Services Board, but on commencement of the Financial Sector Regulation Act, the "Authority" will be the newly established Financial Sector Conduct Authority. This means that market participants who satisfy the definition of an ODP must submit an application for authorisation to the Financial Services Board within 6 months from 9 February 2018. What will pose a challenge to ODPs is that that the board notice which sets out the authorisation criteria to be complied with as an authorised OTC derivative provider is still only in draft form. This board notice and authorisation criteria must be published in final form as soon as possible to allow ODPs to meet the 6 month deadline.

Trade reporting:

In terms of Regulation 3 of the FMA Regulations, an authorised ODP must report OTC derivative transactions to a licensed trade repository or a licensed external trade repository. To date, there is no licensed local or external trade repository in South Africa so presumably authorised ODPs will only commence reporting once a licensed trade repository has been established.

Central clearing:

In terms of Regulation 4 of the FMA Regulations, certain OTC derivative transactions will be subject to mandatory central clearing through a licensed central counterparty or licensed external central counterparty. The FMA Regulations predominantly provides for the asset, resource and operational requirements with which a central counterparty must comply however, to date, the list of OTC derivative transactions that will be subject to mandatory central clearing has not yet been published and there is currently no central counterparty that is licensed in terms of the FMA to centrally clear the designated OTC derivative transactions.

Margin:

The final board notice detailing the margin requirements for non-centrally cleared OTC derivatives transactions is also still pending. For more information on the margin requirements, see our article dated 19 February 2018:

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Bridget King and Sascha Graham

Click here to read the South African FinTech chapter for Chambers Global 2018, authored by Directors **Preeta Bhagattjee, Bridget King, Deon Wilken and Associate Sascha Graham**

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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