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FINANCE & BANKING ALERT

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CDH

CLIFFE DEKKER HOFMEYR

GROUND-BREAKING DRAFT LEGISLATION ALIGNS SA BANKS WITH THE REST OF THE G20

Both in South Africa and in other G20 member states, new regulations have been promulgated to ensure that the OTC derivatives markets are safer and more efficient.

A revised draft of the Financial Matters Amendment Bill (Bill) has been made available by the National Assembly's Standing Committee on Finance (SCoF). If enacted, the Bill will update the South African Insolvency Act so that it aligns with the new laws that regulate the trading of over-the-counter (OTC) derivatives. This change has been welcomed by banks and financial institutions alike and will go a long way to facilitating the exchange of bilateral initial margin.

How do the new laws affect South Africa?

Both in South Africa and in other G20 member states, new regulations have been promulgated to ensure that the OTC derivatives markets are safer and more efficient. One of the new laws requires that any OTC derivatives transactions which are not cleared through a central counter-party, must be subject to additional mandatory margin requirements. In South Africa the laws have been implemented through the Financial Markets Act, 2012 (FMA) and the associated Conduct Standards and Joint Standards for:

1. registration and Code of Conduct for OTC derivatives providers;
2. trade Reporting requirements for OTC derivatives transactions; and
3. draft Margin Requirements for non-centrally cleared OTC derivatives transactions.

What was the problem with our old laws?

South Africa's Insolvency Act was drafted in the 1930s, at a time when the size and extent of global markets trading in financial instruments was not foreseeable. It was significantly outdated. A secured creditor who held collateral for its claims was, upon the Insolvency of its counterparty, obliged to sell the collateral and then to pay the proceeds from the sale of that collateral over to the liquidator. After a lengthy period of time, the secured creditor would then prove its claim and wait for repayment by the liquidator (following deduction of liquidator's costs etc). In the context of the global derivatives market, by preventing a secured creditor from accessing the proceeds of the collateral it was holding, that secured creditor is placed at risk of becoming financially distressed or insolvent itself, thus causing a domino effect of failing institutions.

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What do the new laws provide

The Prudential Authority and Financial Sector Conduct Authority jointly issued a draft Joint Standard under the auspices of the FMA which requires (among others) that:

1. certain covered entities (essentially the large banks and regulated financial institutions) must pledge initial margin as collateral for their obligations arising under an uncleared OTC transaction; and
2. that initial margin must be "immediately available" to the secured party in the event that its counterparty goes insolvent.

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Certain of South Africa's banks will come into scope for the initial margin requirements prescribed by foreign laws (like Dodd-Frank in the USA) on 1 September 2019.

Whilst the Joint Standard is still in draft form, indications from the Prudential Authority are that it will be finally promulgated by 1 September 2019. More importantly, certain of South Africa's banks will come into scope for the initial margin requirements prescribed by foreign laws (like Dodd-Frank in the USA) on 1 September 2019.

Thus the introduction of the Bill could not have come at a better time. The Bill seeks to amend the Insolvency Act to specifically provide for a secured creditor under a "master agreement" (including an ISDA master agreement used to document the trade of OTC derivatives) to immediately realize the pledged asset it was holding as collateral, and to retain the proceeds and apply those proceeds to the debt owed to it under the master agreement.

Are we at the end of the road yet?

We are by no means at the end of the road yet. The current draft of the Bill must still go to the National Council of Provinces next week, and then to the president for signature.

Why is this important for the market?

Aligning our laws with those of the G20 will allow South African banks and financial institutions to keep trading derivatives with G20 banks, and more importantly to enable all parties to accept and pledge initial margin as required by the new laws. This enhances the stability of the derivatives market and the banking system as a whole.

Bridget King

CLIFFE DEKKER HOFMEYR

GOOD NEWS AND BAD NEWS FOR OTC DERIVATIVES PROVIDERS

ODP must adhere to the documentation listed above which, according to the FSCA, will be published by the FSCA on 15 March 2019.

After much lobbying, the regulators have agreed to extend the deadline for lodging an application for registration as an over-the-counter derivatives provider (ODP).

The Financial Sector Conduct Authority (FSCA) confirmed on Friday, 1 March 2019, that it would be releasing the following key documents upon which over-the-counter derivative providers (ODPs) must rely upon, when submitting their applications for registration in terms of Conduct Standard 1 of 2018:

1. a set of Application Instructions;
2. an Application Index; and
3. a Capital Adequacy Calculation template.

ODP must adhere to the documentation listed above which, according to the FSCA, will be published by the FSCA on 15 March 2019. Therefore, for those ODPs who have already started collating their application documents, these applications should be reconsidered and aligned with the new documents and templates which the FSCA will prescribe in two weeks' time.

Applicants for ODP registration have an extra two and a half months to submit their applications.

The good news is that applicants for ODP registration have an extra two and a half months to submit their applications, as the 1 April 2019 deadline has been extended to 14 June 2019.

Background

In terms of the Financial Markets Act, 2012 and the regulations made pursuant thereto, any person transacting as principal who (as a regular feature of business):

- originates, issues or sells OTC derivatives; or
- makes a market in OTC derivatives,

must be licensed as an authorised ODP with the FSCA. Only once authorised, may an ODP hold itself out of advertise as an ODP or otherwise act as an ODP.

Exemptions

The Regulations refer to the power of the FSCA to exempt an ODP from the requirement to be authorised. We would recommend that any such exemption applications also be submitted before the 14 June 2019 deadline.

Bridget King

OUR TEAM

For more information about our Finance & Banking practice and services, please contact:

Deon Wilken
National Practice Head
Director
T +27 (0)11 562 1096
E deon.wilken@cdhlegal.com

Stephen Boikanyo
Director
T +27 (0)11 562 1860
E stephen.boikanyo@cdhlegal.com

Adnaan Kariem
Director
T +27 (0)21 405 6102
E adnaan.kariem@cdhlegal.com

Bridget King
Director
T +27 (0)11 562 1027
E bridget.king@cdhlegal.com

Jacqueline King
Director
T +27 (0)11 562 1554
E jacqueline.king@cdhlegal.com

Izak Lessing
Director
T +27 (0)21 405 6013
E izak.lessing@cdhlegal.com

Mashudu Mphafudi
Director
T +27 (0)11 562 1093
E mashudu.mphafudi@cdhlegal.com

Preshan Singh Dhulam
Director
T +27 (0)11 562 1192
E preshan.singh@cdhlegal.com

Pierre Swart
Director
T +27 (0)11 562 1717
E pierre.swart@cdhlegal.com

Vusiwe Ngcobo
Senior Associate
T +27 (0)11 562 1329
E vusiwe.ngcobo@cdhlegal.com

Stephanie Goncalves
Associate
T +27 (0)11 562 1448
E stephanie.goncalves@cdhlegal.com

Kgotso Matjila
Associate
T +27 (0)11 562 1215
E kgotso.matjila@cdhlegal.com

Jordan Maze
Associate
T +27 (0)21 481 6361
E jordan.maze@cdhlegal.com

Sidasha Naidoo
Associate
T +27 (0)11 562 1422
E sidasha.naidoo@cdhlegal.com

Andile Sangweni
Associate
T +27 (0)11 562 1046
E andile.sangweni@cdhlegal.com

Mashudu Thidiela
Associate
T +27 (0)11 562 1862
E mashudu.thidiela@cdhlegal.com

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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.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

CLIFFE DEKKER HOFMEYR