

CONSULTATION REPORT¹: JOINT STANDARD 1 OF 2021 - REQUIREMENTS RELATING TO CENTRAL COUNTERPARTY LICENCE APPLICATIONS

FINANCIAL MARKETS ACT NO. 19 OF 2012

FINANCIAL SECTOR REGULATION ACT NO. 9 OF 2017

MARCH 2021

Summary of consultation process

1. The Authorities, hereby under section 104(1) of the Financial Sector Regulation Act, publish this report on consultation undertaken during the making of Joint Standard 1 of 2021 (Joint Standard) as set out in comment matrix in the **Schedule**.
2. On 5 December 2019, the Authorities published, in accordance with section 98 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act), a draft Joint Standard for a six (6) week public consultation period until 21 February 2020. The Joint Standard was published together with accompanying documents as required under section 98(1)(a) of the FSR Act and the Authorities invited submissions in relation to the draft Joint Standard in accordance with section 98(1)(a)(iv) of FSR Act.
3. The following documents were published as part of the public consultation process:
 - Draft Joint Standard on Requirements relating to Central Counterparty Licence Applications;
 - Statement of the need for, expected impact and intended operation of the draft Joint Standard; and
 - Comments Template for submission of comments.
4. At the close of the public consultation period, the Authorities received written submissions from 3 institutions that included a Market Infrastructure, an Audit firm and an Industry Representative Body.
5. Comments received from the public consultation process were incorporated into the draft Joint Standard. All comments received as part of the public consultation process were considered and are set out in the table below, together with the Authorities' response to the all comments received.

¹ This report is issued as required in terms of section 104, read with 103(1)(b), of the Financial Sector Regulation Act, 2017 (Act No.9 of 2017).

6. The following key concerns were raised during the public consultation process:

Key concern	Response from the Authorities
It was proposed that the application form should provide details in respect of the manner an applicant CCP that intends to provide clearing of OTC derivatives will fulfil the trade reporting obligations.	The Authorities agreed to request such detail, contained in Conduct Standard 3 of 2018, as part of the application for a CCP license.
Concerns were raised that a CCP applicant might not have an approved rulebook in place at application stage.	The Authorities are of the view that such a requirement is aligned to section 47(3)(c)(v) of the Financial Markets Act, which prescribes that applicants applying to be licensed as a CCP must provide a copy of their proposed rules. Additionally, Board Notice 104 of 2013 requires the same from applicants wanting to be licensed in terms of a specific provision in the Financial Markets Act. The requirement was therefore retained.
Concerns were raised that a CCP at the time of application to be licensed as a CCP, may not have any clearing members, and the clearing members of the applicant licensee may not, at the time of application, have been evaluated or assessed by the applicant in terms of any integrity or capital adequacy requirements as per the proposed rules. Therefore, the CEO of the applicant would be unable to make a statement as proposed in the draft Joint Standard ensuring that proposed clearing members meet all their regulatory obligations in order to be admitted as clearing members.	The Authorities are of the view that this requirement is aligned with Board Notice 104 of 2013 and the same requirement applies to other applicants of Market Infrastructures and licensed Market Infrastructures. The requirement was therefore retained.
It was proposed that the application form should provide for other or alternative internal financial models that deviates from the prescribed models proposed in the FMA Regulation published in 2018.	The Authorities are of the view that the models that are prescribed in the Regulations must be the models that the CCP adopts, and where an entity proposes to deviate, this must be approved by the Authorities.
Concerns were raised in respect of the requirement to provide details of the compensation fund(s); insurance, guarantee or other warranty of the applicant and commented that section	The Authorities are of the view that the applicant must provide a report of an assessment undertaken in respect of the need for the arrangements instead of it being a

Key concern	Response from the Authorities
49(2)(b) of the FMA does not oblige a CCP to have insurance, a guarantee, compensation fund or other warranty in place to provide compensation to clients of clearing members.	requirement for licensing. The Authorities will then as part of considering the license application consider the report and engage the applicant on the need for insurance or a guarantee where necessary.
Concerns were raised in respect of the potential negative implications such as potential fragmentation of markets, limited benefits, retaining liquidity and first mover advantage in enabling the establishment of a local CCP through the Joint Standard.	The Authorities are of the view that the potential implications are not as a result of the Joint Standard, but rather as a result of the policy position already reflective in the Financial Markets Act. In the Authorities' view, the Financial Markets Act is not biased towards a local or external CCP. The legislative framework creates an enabling framework and detailed analysis has informed the approach of allowing a local or external CCP to be licensed in the South African market. At this stage, it cannot be definitively stated that a local CCP will result in the potential negative implications as outlined. The establishment of a CCP is in development and the Authorities will remain cognisant of the potential implications as highlighted.

7. The Authorities held the opinion that the comments received during the public consultation period did not raise any significant policy concerns and did not necessitate any material changes to the draft Joint Standard that was published for consultation. As such, the Authorities did not publish the draft Joint Standard for a second round of public consultation and proceeded to submit the draft Joint Standard to Parliament in terms of section 103 of the FSR Act.
8. In accordance with section 103 of the FSR Act, the Joint Standard and supporting documents were tabled with Parliament on 12 November 2020 (with the National Assembly and the National Council of Provinces) and the required 30-day period in Parliament has since lapsed. There were no concerns or comments raised during the 30-day Parliamentary process.
9. This consultation report is therefore drafted in fulfilment of section 104 of the FSR Act. The detailed comments and responses in respect of the public consultation process are set out in the **Schedule** below.

SCHEDULE

COMMENT MATRIX: DRAFT JOINT STANDARD - REQUIREMENTS RELATING TO CENTRAL COUNTERPARTY LICENCE APPLICATIONS

Response to comments received through the public consultation process on the Draft Joint Standard – Requirements Relating to Central Counterparty Licence Applications

The following comments as per the matrix below have been captured as at August 2020:

No	Commentator	Reference/Section/Paragraph	Comment/ Issue	Response from Authorities
Draft Joint Standard				
1.	Deloitte	Definitions “durable medium”	We recommend that a maximum time be prescribed, for example five or seven years, which would align to information and data security best practice.	Agreed. Please refer to the amendment of the definition as suggested. .
Annexure 1 to Form CCP1				
2.	BASA	General	Where the CCP intends to provide clearing of OTC derivatives, detail should be provided in respect of the manner the CCP will fulfil the trade reporting obligations (including reporting infrastructure and any existing arrangements with a Trade Repository).	<p>Agreed. The Authorities propose to request the following information that the applicant must provide as part of the application for a CCP license:</p> <ul style="list-style-type: none"> i. List of asset classes to be reported by the ODP ii. Proof of ability to generate the report in Annexure A of “FMA <p>Conduct Standard 3 of 2018 - conduct standard for reporting obligations</p>

No	Commentator	Reference/Section/Paragraph	Comment/ Issue	Response from Authorities
			<p>In general, consideration should be given to issues around recovery and resolvability of CCPs.</p>	<p>in respect of transactions in over-the-counter derivatives”</p> <p>iii. Reasons for inability to generate the report, if applicable</p> <p>iv. Confirmation of daily reporting by the ODP</p> <p>v. Details of the licensed Trade Repository that will be used for the reporting of transactions, if applicable.</p> <p>The Authorities are working on a separate Joint Standard prescribing minimum requirements for recovery plans of market infrastructures.</p>

No	Commentator	Reference/Section/Paragraph	Comment/ Issue	Response from Authorities
3.	JSE Clear	Section 3(d)	At the time of application to be licensed as a CCP, the applicant licensee will not have any clearing members as it will not yet be a licensed entity, and also will not have in place an approved rulebook (via which the process and criteria for clearing member applications, as well as membership supervision will be governed). Therefore, we propose that section 3(d) of Annexure 1 be deleted.	Disagree. We assume you are referring to 3(a) of Annexure 1, and not 3(d) as the latter relates to a list of clearing members and not the proposed rules. Please note that paragraph 3(a) is aligned to section 47(3)(c)(v) of the FMA which provides that applicants must provide a copy of the proposed rules. Additionally, Board Notice 104 of 2013 requires that applicants provide a copy of their rules – as per section 7 and under the additional information for an independent clearing house license – as per section 2 of the Board Notice.
4.	JSE Clear	Section 3(g)	The information requested in this section should specifically refer to requirements prescribed in joint standards as stated in section 48(1)(d) of the FMA otherwise it will not be clear which requirements are being referred to.	The comment is accepted. A reference to “...in joint standards” will be included.
5.	JSE Clear	Section 3 (j) and section 3(m)	Both of these sections of Annexure 1 make reference to “arrangements in place for the efficient and effective...monitoring of clearing members so as to ensure compliance with the clearing house rule...”. We propose that this duplication be resolved, or that the sections be reworded if the regulator intended to specify 2 separate requirements.	Agreed. The Authorities agree to the deletion of 3(m) and retaining section 3(j)

No	Commentator	Reference/Section/Paragraph	Comment/ Issue	Response from Authorities
6.	JSE Clear	Section 3(k)	<p>The steps to be taken to discipline clearing members for non-compliance are required to be set out in the rules of the CCP in terms of section 53(2)(o) of the FMA. Therefore this requirement should be covered in the proposed rules of the CCP submitted with the application. Disciplinary steps are not covered by any of the requirements in sections 48, 49 or 50 of the FMA. Therefore, we propose that section 3(k) of Annexure 1 be deleted.</p>	<p>The Authorities agree to the deletion of section 3(k). The Authorities will instead assess this through the rules that are provided with the application.</p>
7.	JSE Clear	Section 4	<p>Section 62(a) of the FMA refers to requirements prescribed by the Authority. These requirements have been prescribed in Board Notice 1 of 2015. We suggest that, in addition to section 62 of the FMA, section 4 of Annexure 1 also refers to the requirements prescribed by the Authority.</p>	<p>Agreed, Section 4 will be reworded as follows: “Details of arrangements to be implemented in order to comply with section 62 of the Act, read with Board Notice 1\2015 and any other requirements as may be prescribed by the Authorities. “</p>
8.	JSE Clear	Section 5	<p>At the time of application to be licensed as a CCP, the applicant licensee may not have any clearing members, as is the case with JSE Clear. Furthermore, proposed clearing members of the applicant licensee may not, at the time of application, have been evaluated or assessed by the applicant in terms of any integrity or capital adequacy requirements to be set out in the proposed rules of the applicant. Therefore, the CEO of the applicant would be unable to make the statement contemplated in section 5 of Annexure 1 at the time that the application is submitted. Ensuring that proposed clearing members meet all of their regulatory obligations in order to be admitted as clearing members is part of the</p>	<p>The comment is noted, however, the requirement is aligned to Board Notice 104 of 2013 and the requirements that apply to other licensed market infrastructures. The existing licensed market infrastructures have therefore been licensed with the same requirements as reflected in Board Notice 104 of 2013.</p>

No	Commentator	Reference/Section/Paragraph	Comment/ Issue	Response from Authorities
			<p>membership application process applied by the CCP. This process must be undertaken by the applicant licensee or licensed CCP prior to it admitting any clearing members once its CCP license has been granted. But this process would not have been completed at the time that the license application is submitted and therefore we propose that the requirement for the statement from the CEO in section 5 of Annexure 1 be deleted.</p>	
9.	Deloitte	Section 8	<p>A report by an independent party, including an external auditor, to include, in addition to the listed requirements, an independent model validation report on all financial models used, in particular models relating to</p> <ul style="list-style-type: none"> • Counterparty credit risk exposures & capital requirements • Credit risk exposures & capital requirements • Operational exposures & capital requirements • Market risk exposures & capital requirements • Liquidity risk • Pricing models • Collateral valuation models • Default fund contribution calculations • Stress testing and back testing models <p>Especially in the event that the CCP wants to adopt internal models that deviates from the prescribed models proposed in the FMA Regulation published in 2018.</p>	<p>The proposed inclusion is not accepted.</p> <p>The models that are prescribed in the Regulations must be the models that the CCP adopts, and where an entity proposes to deviate, this must be approved by the Authorities.</p>

10.	JSE Clear	Section 9	<p>Section 49(2)(b) of the FMA does not oblige a CCP to have insurance, a guarantee, compensation fund or other warranty in place to provide compensation to clients of clearing members. This section instead states that a CCP license may specify that such arrangements must be put in place by the CCP. The requirement for such arrangements to be put in place will therefore be determined by the Authority in granting the license. In making this determination, we assume that the Authority will consider the possible nature and extent of the risk of loss to clients of clearing members taking various factors into account, including whether the risk of loss to clients is adequately mitigated or addressed through other arrangements that do not necessitate the CCP making further arrangements.</p> <p>Therefore we propose that rather than assuming that the applicant has implemented one or more of the arrangements contemplated in section 49(2)(b) of the FMA, section 9 of Annexure 1 instead requests the applicant to provide details of the assessment that it has undertaken to determine whether the risk of loss to clients of clearing members requires the CCP to implement such arrangements and, if so, to then provide the information currently requested in section 9 of Annexure 1. The details of the assessment undertaken by the applicant will assist the Authority to determine whether the CCP license should specify that the CCP needs to implement appropriate compensation arrangements for clients of clearing members.</p> <p>We also note that the first line of section 9 only refers to compensation funds whereas section 9(a) includes other types of compensation arrangements. The limited reference to compensation funds in the first line should be corrected.</p>	<p>Partially agreed. The wording in the draft joint standard has been amended to reflect that the applicant must provide the Authorities with a report of an assessment undertaken in respect of the need for the arrangements instead of a requirement for licencing. The Authorities will then as part of considering the license application consider the report and engage the applicant on the need for insurance or a guarantee where necessary.</p> <p>Agreed. Will be amended accordingly.</p>
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No	Commentator	Reference/Section/Paragraph	Comment/ Issue	Response from Authorities
11.	JSE Clear	Section 10	<p>It is unclear what information is being requested in section 10 of Annexure 1. Is section 10 requesting an applicant to submit all information that it believes evidences its compliance with all Regulations issued by the Minister that are applicable to the holder of a license for which the applicant is applying?</p> <p>The Regulations prescribe further, more detailed requirements in relation to matters set out in the licensing requirements in sections 48 to 50 of the FMA. The requirements in sections 48 to 50 of the FMA are already covered in the other sections in Annexure 1. If the information requested in section 10 of Annexure 1 is intended to supplement (and not duplicate) the information requested in the other sections in Annexure 1, section 10 should clearly state this. To avoid uncertainty and duplication in terms of the information requested in section 10 versus the information requested in the other sections of Annexure 1, section 10 should state the specific information being requested to evidence compliance with specific sections of the Regulations, if this is in fact the intention of section</p>	<p>The intention is for the applicant to submit all information in order to demonstrate compliance with the regulatory requirements. To the extent that there is duplication, the applicant can cross reference to information provided under Annexure 1.</p>
Annexure 2 to Form CCP 1				
Annexure 3 to Form CCP 1				

Comments on the Statement of need, impact and intended operation of the draft Joint Standard

No	Commentator	Comment from Commentator	Response from Authorities
Statement of need, impact and intended operation			
General comments			
1.	BASA	<p>As the actual Standard itself does not impact a bank who is not applying to be licensed as a CCP, the following comments are provided on the theoretical premise that a CCP has already been licensed locally, and the potential negative unintended impacts this may have on the industry:</p> <ol style="list-style-type: none"> 1) Benefits are limited because local dealers who clear on the local CCP are not typically as well-resourced as global dealers who participate in global CCPs; the default of a local dealer would be more costly for a local CCP to absorb. This would impact on the desirability of large international banks to participate in the SA market. They would rather transact where the netting and liquidity benefits are at their greatest. 2) Local teams would have to manage margin in two places (local and foreign) and this is likely to involve different currencies, which is more operationally intensive. 3) Retaining liquidity in both local and foreign CCPs would affect risk reduction as it would reduce the effectiveness of banks being able to reduce their gross notional exposure in derivatives portfolios through portfolio compression. 4) There is a first mover advantage in creating a CCP, for example the London Clearing House (LCH) made a “first move” to set up as a CCP and thereby hold 95% of the Rand volume compared to the Chicago Mercantile Exchange (CME), who came in later. 	<p>The comments are noted.</p> <p>The purpose of the draft Joint Standard is to prescribe the process that CCPs must follow when submitting a license application under section 47 of the FMA.</p> <p>A section discussing these concerns have been included in part 4.2 of the statement of need.</p>

No	Commentator	Comment from Commentator	Response from Authorities
		<p>A local CCP would therefore most likely attract a low clearing volume. This would result in comparatively (e.g. against LCH) higher default risk, higher costs due to lower number of transactions and lower liquidity due to the number of participants and transactions which would most likely be limited to local firms.</p> <ul style="list-style-type: none"> - An argument in favour of creating a local CCP existed previously when LCH only cleared swaps with a 10.5-year maturity. This has changed since November 2020 when LCH extended the maturity to 31 years, thereby creating more liquidity in the market. <p>5) A local CCP may fragment the global market for rand-dollar interest rate swaps. This will add to the cost and complexity of clearing and place the SA market participants at a competitive disadvantage.</p> <ul style="list-style-type: none"> - More than 40% of the liquidity in SA is held by foreigners. The SA market is biased toward converting floating liabilities into fixed rates. Offshore entities (who receive the fixed rate and pay out floating rates) would prefer exposure to emerging markets, especially SA which has real interest rates. Creating a local CCP would bifurcate the markets as the payer of fixed rates would exist locally and the receivers of fixed rates would exist offshore. When SA enters interest rate hedges, the liquidity does not come back into the market. - Separation of Rand from the G10 countries (market fragmentation), <p>6) The potential fragmentation of markets through the establishment of a local CCP can create a pricing differential</p>	

No	Commentator	Comment from Commentator	Response from Authorities
		<p>between the local and foreign market. This would be a result of the reasons detailed above e.g. separating Rand from the G10 countries (market bifurcation), thereby losing scale (smaller scale results in higher per transaction costs (per CCP pricing norms) as well as lower liquidity in markets (local and foreign) together with increased default risk.</p> <ul style="list-style-type: none"> - Example of price differential in Japan – the Japanese local CCP (JSCC) indicates an 18-month Yen swap at 1,81, whereas LCH indicates it at 1,75. 	
Do you support the implementation of the draft Joint Standard? Please provide reasons for your answer.			
2.	Deloitte	Deloitte support the implementation of the Joint Standard, as it clears the way for a local CCP. A local CCP is a critical instrument, specifically for the OTC derivatives market, required to meet G20 regulatory reform objectives and to make SA Inc. an attractive investment destination for international investment, by promoting financial stability and mitigating systemic risk (a cause of financial instability in the past in international financial markets).	Noted.
3.	JSE Clear	The implementation of the joint standard is supported, as it provides greater clarity regarding the information that the authorities expect to be contained in an application for a CCP licence. With the joint standard in place applicants will be able to more clearly determine what information, evidence or artefacts need to be included in application submissions, creating a base standard that all applicants are expected to satisfy.	Noted.
4.	BASA	Yes. The licensing of external infrastructure will facilitate access to OTC risk mitigation services for SA entities. The experience in these areas will benefit SA market participants, who will be able to leverage	Noted, although the Authorities do not express preference in respect of a local or external CCP.

No	Commentator	Comment from Commentator	Response from Authorities
		these benefits at a reduced cost due to economies of scale	
<p>Will the requirements of the draft Joint Standard lead to:</p> <p>a) a reduction in consumer choice; b) higher prices due to less competition; c) the creation of barriers for new entrants and service providers; d) facilitation of anti-competitive behaviour or emergence of monopolies; and e) market segmentation.</p>			
5.	JSE Clear	The joint standard should have no impact on any of these considerations, as it specifies the requirements for a CCP licence application, and not the preferred structure, form or operations of the entity seeking to be licenced. Additionally, the cost of formulating and compiling the application content is not seen as been prohibitive, and should not preclude or discourage potential applicants.	Noted.
6.	BASA	No. We believe that the failure to recognise external applicants will lead to reduction in choice and higher prices. Further clarity needs to be provided on the impact once a licence has been granted – if it is not the intention of the Authority to mandate the use of any provider, whether local or offshore, we do not foresee these impacts materialising.	It is not the intention of the Authorities to mandate the use of any provider. The Authorities will assess the license applications from a local or external market infrastructure within the prescripts of the FMA.
<p>Will the Joint Standard impose additional compliance costs on the business? If yes, please provide details including the expected costs?</p>			
7.	JSE Clear	Apart from the cost associated with employing the services of an independent auditor to satisfy the requirements in Section 8, no additional compliance costs have been identified at this time.	Noted and included in the statement of need and expected impact of the draft joint standard.

No	Commentator	Comment from Commentator	Response from Authorities
8.	BASA	<p>Unlikely – the costs will likely be borne by the Applicant infrastructure, although care should be taken that these are not passed on to the end consumer.</p> <p>The fee and cost structure should be transparent to all current and future members. This also depends on whether the Authority will mandate the use of any provider, which will reduce competition and limit choice of financial institutions</p>	<p>Same as above. It is not the intention of the Authorities to mandate the use of any provider. The Authorities will assess the license applications from a local or external market infrastructure within the prescripts of the FMA.</p>
How do you anticipate the draft Joint Standard will affect the operational cost of the business?			
9.	JSE Clear	<p>No impacts on operational costs have been identified at this time.</p>	<p>Noted and included in the statement of need and expected impact of the draft joint standard.</p>
10.	BASA	<p>Indirectly as costs of clearing and reporting will impact financial institutions</p>	<p>Same as above.</p>
If an increase in operational cost is expected, who will bear the cost and why?			
11.	JSE Clear	<p>No impacts on operational costs have been identified at this time.</p>	<p>Noted and included in the statement of need and expected impact of the draft joint standard.</p>
12.	BASA	<p>No comments</p>	<p>Noted.</p>
Do you anticipate that business models may need to change as a result of the draft Joint Standard? If yes, please provide details including the expected costs.			
13.	JSE Clear	<p>We do not anticipate that business models will need to change as a result of the draft Joint Standard.</p>	<p>Noted and included in the statement of need and expected impact of the draft joint standard.</p>
14.	BASA	<p>No comments</p>	<p>Noted.</p>

No	Commentator	Comment from Commentator	Response from Authorities
How will different customer groups be impacted by the requirements of the draft Joint Standard?			
15.	JSE Clear	We do not anticipate that any customer groups will be impacted as a result of the draft Joint Standard.	Noted and included in the statement of need and expected impact of the draft joint standard.
16.	BASA	This will depend on the approach taken by the Authority in respect of mandating the use of any provider	Noted.
Will the risk of increased prices to consumer be mitigated by greater transparency and competition?			
17.	JSE Clear	We do not anticipate that the Joint Standard, in itself, will result in increased prices to consumers	Noted.
18.	BASA	Only if competition is encouraged and the Authorities do not compel the use of any provider.	It is not the intention of the Authorities to mandate the use of any provider. .
Are transitional arrangements necessary to implement the Standard? If yes, what transitional arrangements do you propose and for which section of the draft Joint Standard?			
19.	JSE Clear	No.	Noted and included in the statement of need and expected impact of the draft joint standard.
20.	BASA	No.	Same as above.
Do you find the format of the Joint Standard user-friendly and simple to understand? If no, please provide suggestions for improvement.			
21.	JSE Clear	Although the format is simple enough to follow, the sequencing of some of the requirements could be reconsidered, as it may make more sense to have requirements dealing with similar concepts (the IT resources referenced in Sections 3(h), (n) and (u)) sequenced together.	Noted.
22.	BASA	No – this is cumbersome by replicating the contents of the FMA unnecessarily	Noted.