Financial Sector
Conduct Authority

CONSULTATION REPORT

DRAFT CONDUCT STANDARD -

CONDITIONS FOR INVESTMENT IN DERIVATIVE INSTRUMENTS FOR PENSION FUNDS

PENSION FUNDS ACT, 1956 (ACT NO. 24 OF 1956)

FINANCIAL SECTOR REGULATION ACT, 2017 (ACT NO. 9 OF 2017)

Consolidated comments and responses to public comments

May 2023

1. Purpose

The purpose of this document is to set out, as required in terms of section 104(1) of the Financial Sector Regulation Act, 2017 (FSR Act), a report on the consultation process undertaken in respect of the draft Conduct Standard – Conditions for Investment in Derivative Instruments for Pension Funds.

2. Summary of public consultation process

2.1 This consultation report must be read with the Statement supporting the draft Conduct Standard – Conditions for Investment in Derivative Instruments for Pension Funds.

2.2 On 8 June 2020, the Financial Sector Conduct Authority (FSCA or Authority) published for public comment a draft Notice proposing conditions for investment in derivative instruments by pension funds. The FSCA published the following documents together with the draft Notice:

- Draft Conduct Standard - Conditions for Investment in Derivative Instruments for Pension Funds (draft Conduct Standard);
- Statement explaining the need for, intended operation and expected impact of the draft Conduct Standard; and
- Comments Template.

2.3 A total of **236** individual comments were received from 18 different commentators on the draft Conduct Standard that was published for public consultation.

2.4 All comments received as part of the public consultation process were considered and are set out in the table as per the Schedule below, together with the FSCA's responses to the comments received.

2.5 To the extent that the FSCA agreed with commentary received, amendments were made to the draft Conduct Standard accommodating such comments*.*

3. General account of the issues raised in the submissions made during the consultation process

A general account of the issues raised in the submissions made during the consultation process are set out in the table below:

#	Issue	FSCA response
1.	Commentators were concerned with conditions for use of derivatives such as the requirement in subclause 2(2) that where a fund uses a derivative instrument for the purposes of hedging and efficient portfolio management, the effective economic derivative exposure must at all times be covered by appropriate reference assets. Commentators opined that this would not allow a fund to have any net long or short positions that are not covered by an appropriate reference asset i.e. all net derivative positions would effectively be a hedge. This doesn't allow for any active management, for the purposes of	The FSCA notes the comments. Long and short positions are allowed as long as they are covered positions and netting provisions are adhered to. The use of derivatives is restricted to limit losses to capital commitments of the fund and limited liability structures hence a fund must hold covered positions at all times. The duration for debt instrument reference assets needs to be taken into account when using derivatives. The FSCA disagreed with the proposal from some commentators to remove reference to "reference asset". FSCA is of the view that the word "reference asset" must be retained. This is

	generating alpha for the fund, within reasonable risk parameters, by the FSP. Further, commentators were of the view that this subclause implies that a fund may not hold a derivative instrument unless the fund has an exposure to the underlying reference asset or assets (e.g. as a hedge 'covering' an underlying reference asset). Commentators were of the view that it is necessary that a fund is able to enter into a derivative instrument to hedge against a number of risks (e.g. counterparty risk) without having exposure to underlying assets. This limitation would prevent a fund, (seeking to improve performance) from using a derivative to move into a position, or prevent a fund (seeking to protect capital or income) from using a derivative to hedge the fund's long dated liabilities (which could be in excess of 45 years), as government bond maturities seldom extend past 30 years.	important in the context of the look though principle being applied in terms of Regulation 28(4). Further, "reference asset" is crucial to ensure that covered positions and netting provisions are complied with. Further drafting improvements have been made to paragraph 2(2) of the Standard. The FSCA is of the view that the drafting improvements made will enhance cost efficiency in the use of derivatives by pension funds. Additionally, the drafting improvements give effect to the original regulatory intent.
2.	Commentators expressed views regarding the requirement that the value of all derivative instruments held by a fund may not exceed 25% of the value of the fund's assets. The commentators argued that the limit is unreasonably restrictive and may negatively impact the responsible management of a fund's assets. Secondly, commentators were concerned that a fund will be precluded from investing in CIS portfolios and insurance policies as these regulated products are not subject to similar limits. Thirdly, commentators were of the view that the proposed limit is not proportional and differing asset-liability profiles of funds are disregarded. Finally, commentators contended that he overarching requirements for the management of a fund's assets (including limits per entity/issuer/asset category) set out in Regulation 28 in conjunction with the risk management requirements envisaged by the Draft Conduct Standard, adequately controls exposure to derivatives.	Derivative instruments in a pension fund can be used for a variety of purposes. According to International Organisation of Pension Supervisors (IOPS), basic derivative contracts can be used by pension funds to hedge their risk exposure to specific financial instruments, both on the asset and liability side. Further, derivatives can also be used to change the characteristics of the fund's portfolio investments, such as the duration of the fixed income portfolio. The Authority recognises that there is a role for the use of derivatives within pension funds' portfolios, however there are a number of major risks inherent in these instruments. The Authority has to strike a balance between benefits and risks offered by derivatives instruments. However, having considered the submissions made by the commentators, the Authority is amenable to removing the limit at this stage and therefore follow a more principles-based approach. At this first stage the focus will be on disclosure, which will then also assist the Authority in monitoring and informing future development and determining whether in the future there is need to have a limit, as there might be merit to it.

		Further, the Authority acknowledges that the other challenge with limits is always setting them at the right level and this requires more information, research and benchmarking etc. As part of the disclosure regime, the Authority will consider other tools such as updates to the Regulatory Reporting Requirements (RRR) to identify any net short positions on derivatives and how such risks are mitigated by the fund.
3.	Commentators were concerned assets and instruments that will constitute eligible collateral for purposes of relevant calculations of initial and variation margin were those as contemplated in the Joint Standard 2 of 2020 on Margin Requirements for Non-Centrally Cleared OTC Derivative Transactions (Joint Standard 2 of 2020). In light of the fact the Authorities have not yet determined what will constitute eligible collateral in Joint Standard 2 of 2020, proposals were made to delete references to the Joint Standard 2 of 2020. Commentators were concerned that this effectively means that a fund will be restricted to cash and gold as eligible collateral.	The FSCA agree with the proposal. The assets or instruments eligible for collateral ("collateral asset") in terms of a collateral arrangement must be the high-quality assets that are liquid, transparent and identifiable as defined by South African Reserve Bank.
4.	Commentators were concerned with the transitional period and opined that funds should have an appropriate time period after the publication of the requirements to review its current policies, processes, and procedures to ensure compliance with the requirements set by the Standard. Compliance would require significant systems development to ensure adherence and sufficient time should be granted. In this light, commentators required a longer implementation period.	Notwithstanding the fact that some of these requirements are already a practice in the market, the FSCA agrees with these comments. The Standard has been amended to provide for a 12 months transitional period. It is envisaged that the longer transitional period will enable pension funds to revise investment policy statements, mandates, align contracts to the Standard and system enhancements.

SCHEDULE

#	Commentators	Acronym
1.	Actuarial Society of South Africa	**ASSA**
2.	Aeon Investment Management Pty (Ltd)	**Aeon**
3.	Association for Savings and Investment South Africa	**ASISA**
4.	Banking Association of South Africa	**BASA**
5.	Eskom Pension and Provident Fund	**Eskom**
6.	Financial Intermediaries Association of Southern Africa	**FIA**
7.	Futuregrowth Asset Management (Pty) Ltd	**Futuregrowth**
8.	Institute of Retirement Funds Africa	**IRFA**
9.	JSE Limited	**JSE**
10.	Khumo Capital Partners	**Khumo**
11.	Legae Peresec	**Legae**
12.	Mergence Investment Managers	**Mergence**
13.	PSG Wealth Financial Planning	**PSG**
14.	PricewaterhouseCoopers	**PWC**
15.	RisCura Solutions (Pty) Ltd	**RisCura**
16.	Sentinel Retirement Fund	**Sentinel**
17.	WWC Asset Management (Pty) Ltd	**WWC**

		SECTION A - COMMENTS ON THE DRAFT CONDUCT STANDARD		
#	**Commentator**	**Section**	**Issue/Comment/Recommendation**	**FSCA Response**
		1. DEFINITIONS		
1.	BASA	Section 1, definition of “Agreement”	The definition should refer to “ISDA” by its correct name, viz. “International Swaps and Derivatives Association Inc. “ It is not clear what is meant by “…a legally accepted agreement for derivative instruments”. We recommend that this could be linked to the definition of a “master agreement” as defined in section 35B of the Insolvency Act	Agree, see amended definition of “agreement”.
2.	BASA	Section 1, definition of “counterparty”	The definition of “Counterparty” refers to a “derivative position” and a “derivative transaction” and in most places elsewhere in the Conduct Standard, “derivative instrument” is used – which seems more appropriate for this definition. Clarification is sought as to why a Central Counterparty is not included in this definition?	The term central counterparty is not used in this Standard and thus no definition is included.
3.	Legae	Section 1, definition of “counterparty”	“counterparty" means, in relation to a derivative position, a juristic person who is the opposite party of the fund in a with whom a pension fund executes a derivative transaction; The party “whom a pension fund executes a derivative transaction” is vague and may include a derivative broker, the FSP or ODP provider facilitating the transaction. The counterparty is the party that has legal obligation to perform under the derivative contract.	Agreed see amended definition Agree, see above

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4.	BASA	Section 1, definition of "Covered"	Clarification is sought on this definition; does this envisage that funds will be delta hedged?	All derivative positions must be covered by the respective reference asset so that when asset is sold the position is closed out
5.	Legae	Section 1, definition of "counterparty exposure"	"counterparty exposure" means any credit or settlement risk exposure in relation to an entity or ~~issuer of a derivative instrument~~ counterparty; The term "counterparty" is already defined and it creates ambiguity to use different wording here for the same entity.	Agree, see amended definition Agree
6.	ASISA	Section 1, definition of "delta"	The previous Draft Conditions for the Use of Derivative Instruments issued in November 2013 ("November 2013 Draft Conditions") defined delta as "the ratio measuring the change in the price of the derivative instrument relative to the corresponding change in the price or 10.value of the reference asset". It is uncertain why the wording of the definition has been changed in this Draft Conduct Standard. The reference to "expected change" is confusing as the calculation of a delta is formulaic. ASISA members suggest that the reference to "expected" should be deleted to avoid confusion. Alternatively, the definition in the November 2013 Draft Conditions should be retained. **Proposed wording:** **"delta"** means the ratio of the ~~expected~~ change in the price of the derivative instrument as a result of a one unit change in the price or value of the reference asset;	Agree, see amended definition

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			or "**delta**" means the ratio ~~expected~~ measuring the change in the price of the derivative instrument ~~as a result of a one unit~~ relative to the corresponding change in the price or value of the reference asset;	
7.	BASA	Section 1, definition of "delta"	The relevance of the term "ratio" is unclear; we suggest the definition should align to the OTC margining regulations once finalised or possibly to ISDA SIMM.	Disagree, the term is not used in isolation but in the context of "delta". The comment only references the term "ratio" within the definition of "delta"
8.	Legae	Section 1, definition of "delta"	"delta" means the ratio of the expected change in the price or value of the derivative instrument as a result of a ~~one unit~~ change in the price or value of the reference asset; Either the term "one unit" must be used in both the derivative price/value and the reference asset price/value or in neither.	Agree, see amendments in the Standard
9.	BASA	Section 1, definition of "derivative instrument"	The term "derivative instrument " is used, but not defined. We recommend an appropriate definition be inserted, confirming the asset classes (interest rates, currency, equities etc.) and the transactions (swaps, options, forwards and futures etc.)	Agree, see amendments in the Standard
10.	BASA	Section 1, definition of "derivative instrument"	➢ Is it intended that the definition of "derivative instrument" shall have the meaning ascribed to it in the Financial Markets Act, or that "derivative instrument" shall only refer to listed derivative instruments?	See above response at item 9. The terms is intended to refer to both listed as well as unlisted instruments, with unlisted instruments subject to the necessary independent valuation or value

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			➢ Is it intended that where the words “derivative instrument” are used, it refers to all classes of “derivative instrument”, but where “OTC derivative” is used, it only refers to unlisted derivatives? ➢ Where does the definition of “derivative instrument” begin and end? It could refer to an Unfunded / Over the Counter / Credit Linked Note / Equity linked note / Forex linked trade? Clarification is sought when it comes to bank issued product. In that case the client will not hold a derivative, it will hold a “note”. And the note will be hedged with a derivative. In some parts of the document, both exchange traded and OTC derivatives are referred to. In sections 5-8 appears to reference OTC derivatives only? ➢ Please provide guidance ➢ Reference is made to listed and OTC derivatives instruments. We note that OTC derivatives is defined in Section 1 but listed derivatives are not. We presume Listed Derivatives are those traded via a Central Counterparty (also not defined see comment above) or is it envisaged that a Counterparty could list a derivative on the JSE via, for example, an applicable Notes Programme.	The reference to “derivative instruments” is in respect of all indirect and direct derivatives as well as “embedded derivatives” See comments above at item 9 The Standard contemplates both listed as well as unlisted derivatives, with unlisted derivatives subject to the necessary independent valuation
11.	Legae	Section 1, definition of “effective economic derivative exposure”	The use of the term “economic exposure” in this definition creates confusion. “Economic exposure”	See respective amendments made to the Standard

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			has a specific well defined meaning in finance where the term refers to exposure to foreign currency. The important term here (already correctly inserted) is "effective" which implies both the delta and the netting of derivatives. Alternative 1: (preferred) "effective ~~economic~~ derivative exposure" means the exposure of a fund to … Remove the term "economic" from the entire regulation. Definition also used in definition of "net effective exposure" and paragraph 2(3), 2(4), 5(1), 6(1), 6(3) and 8(2)(b)	
12.	ASISA	Section 1, definition of "efficient portfolio management"	Derivatives can also be used to generate capital e.g. gaining equity market exposure generates no income but generates additional capital if the equity market rises. In its submission on the November 2013 Draft Conditions, ASISA members provided information on UCITS and the relevant CISCA Board Notice at that time. UCITS defines efficient portfolio management as the use of derivative instruments only in instances where they are economically appropriate, in that they are realised in a cost-effective manner and exposures must be fully covered. The derivatives must be entered into for the specific aim of reducing risk, reducing cost or generating additional *capital or* income for the portfolio with a risk level which is consistent with the risk profile of the portfolio. Section 3(8)(b) of CISCA Board Notice 90 stipulates that financial instruments may only be included for purposes of efficient portfolio management with the	Agree, see amended wording

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			aim of reducing risk, reducing cost or generating *capital* *or* income for a portfolio with an acceptable level of risk or to achieve the investment objective of the portfolio. ASISA members suggest that Proposed wording: **"efficient portfolio management"** means giving effect to the fund's investment policy for one or more of the following objectives- *(a)* hedging; *(b)* the reduction of cost; or *(c)* the generation of additional capital or income for the fund, with a risk level consistent with the fund's investment policy statement; ***(d)***	
13.	BASA	Section 1, definition of "efficient portfolio management"	Clarification is sought as to what is included in "reduction of cost" as an example; buying an option for a single stock call option a reduction in cost in so far as the Fund will have positive exposure to the share price at the cost of premium versus an outlay of the full notional or would this be seen as leverage. It's noted that hedging is defined separately why not reduction in costs? This definition does seem narrow and should take into account synthetic replication of portfolios using derivatives; which doesn't necessarily fall under the definition of hedging- this could be a risk neutral outcome; rather than risk reduction.	Synthetics are excluded as this could indicate "uncovered positions" held on a look though basis as required in Regulation 28(4) Also see comments above at item 12
14.	RisCura	Section 1, definition of "effective economic derivative exposure" … calculation must take into account embedded derivatives	Does the definition imply that there is full look through to an ultimate underlying instrument because of the requirement to take into account the embedded derivatives? As an example: a call option on a JSE	Yes, the full look through principle applies as disclosed in Schedule IA of the prescribed annual financial statements to reference asset

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			ALSI40 future, the reference asset is the JSE ALFI40 future. Our view would be that the effective economic derivative exposure should be on a full look through basis, where the exposure would be to the individual constituents of the index, and not just exposure to the ALSI40 future.	
15.	Legae	Section 1, definition of "external central counterparty"	"external central counterparty" means a licensed external central counterparty as defined in section 1 of the Financial Markets Act; This definition is not used in the regulation	Noted
16.	ASISA	Section 1, definition of "financial services provider"	The reference to the Code of Conduct is not entirely correct. The 2003 Code of Conduct is not a defined term in the Draft Conduct Standard, and it is therefore suggested that it is more appropriate refer to the legislative provision in terms of which the Code of Conduct was published. Proposed wording: "**financial services provider**" means a discretionary FSP as defined in the Code of Conduct for Administrative and Discretionary FSPs~~, 2003~~ published under section 15 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002);	Disagree. The definition merely references the Short title of the Administrative Code, i.e. "Code of Conduct for Administrative FSPs, 2003". It is not necessary to define the short title of legislation. As the short title is Code of Conduct for Administrative FSPs, 2003, and the definition of Discretionary FSP is included in the aforementioned, the definition reads correctly as is
17.	Khumo Capital	Section 1, definition of "financial services provider"	The definition should read: "means a discretionary FSP as defined in the Codes of Conduct for Administrative and Discretionary FSPs, 2003;"	Disagree. See response under item 16
18.	Sentinel	Section 1, definition of "financial services provider"	The definition should read: "means a discretionary FSP as defined in the Codes of Conduct for Administrative and Discretionary FSPs, 2003;"	Disagree. See response under item 16

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19.	ASSA	Section 1, definition of "hedging"	Given that liability valuation bases other than a "fair" value basis are used to value liabilities in the industry (such as those defined in PF Notice 2 of 2016), we recommend deleting this word from the conduct standard to allow for a broader scope of valuations beyond that of fair value and to remain consistent with other regulatory frameworks. Suggestion: Delete the word "fair".	Disagree, the wording "fair value" is retained. See prescribed format of financials and accounting framework for retirement funds (Board Notice 14 of 2009)
20.	BASA	Section 1, definition of "hedging" and "speculation"	If one considers the definitions of "hedging" and "speculation" there seems to be a category of derivatives that fall in between the two? Speculation is prohibited and Hedging is permissible. If there is a gap between the two, what is the status of such transactions?	Speculation is associated with taking extreme risks which the Standard aims to avoid while hedging strategies refer more to risk management and mitigation. Any residual risk is reported in the audited annual financial statements for funds as prescribed (see Note G1 & G2 specifically)
21.	IRFA	Section 1, definition of "hedging"	Proposal - The draft may have a material adverse impact on LDI strategies implemented for retirement funds, specifically the draft may prohibit the use of derivative instruments for liability hedging (and hence LDI) if the liability being hedged is not calculated on an IAS19 basis (notably, no risk premia may be added to bond curves for the IAS19 basis; it is proposed that the definition of hedging be expanded as follows: **hedging**" means reducing risks associated with fluctuations in the: *1. fair value of the fund's assets;* *2. fair value of the fund's liabilities;*	See response to item 20 above Agree, see amendments to the Standard

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			the value of the fund's liabilities calculated using assumptions that are consistent with the most recent valuation approved by the Board in terms of PF Notice 2 of 2016 8."; *or* "*the value of the fund's liabilities, calculated on a basis approved in writing by the Board and the fund's valuator. Such approval by the Board and the valuator will include a motivation for the reasons why this basis differs from the fair value of the fund's liabilities or the most recent basis submitted in terms of PF Notice 2 of 2016 8."*	
22.	ASISA	Section 1, definition of "Jibar"	The Jibar Code of Conduct, Governance Process and Operating Rules issued by the South African Reserve Bank (SARB), the administrator of Jibar, refers to the Johannesburg Interbank Average Rate. Although the JSE refers to the Johannesburg Interbank Agreed Rate in its publication, the reference in this Draft Conduct Standard should be aligned with the reference used in the governance documentation issued by the SARB as the administrator of Jibar. The SARB started a consultation process in 2018 on the reform of key interest rate benchmarks and on the introduction of new benchmarks that could potentially be used as reference interest rates. The SARB proposed that the current Jibar should be phased out and reformed. This process is still underway. It is proposed that the definition of Jibar should be rephrased to provide for a future replacement of Jibar to avoid all derivatives with Jibar as a reference asset	Agree, see amendments to the Standard

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			becoming non-compliant at the time of its replacement. Proposed wording: "**Jibar**" means the Johannesburg Interbank ~~Agreed~~ Average Rate as ~~published by the JSE Limited~~ administered by the South African Reserve Bank, and any replacement of Jibar;	
23.	BASA	Section 1, definition of "Jibar"	We recommend incorporation of a broad definition to cater for reference rate reform	See comment at item 22 above. In respect of reference rate reform that is still under development, it would be premature to attempt to align to regulatory reforms that are still under development and we also do not see what it adds to the definition of Jibar to include such a reference
24.	IRFA	Section 1, definition of **"Jibar"**	Substitute the word "Agreed" with "Average" to read as "means Johannesburg Interbank Average Rate as published by the JSE Limited". This means it is the screen rate or quoted amount.	See comments at items 22 and 23 above
25.	ASISA	Section 1, definition of "leverage"	The reference to "capital employed to an investment" causes confusion. ASISA members, in its submission on the November 2013 Draft Conditions, commented that derivatives by nature involve the use of leverage and that it is more important that the use of derivatives should not result in a net short position *at a fund level*. If the net derivative exposure is covered by appropriate reference assets, the fund cannot be exposed to losing more than the fair value of the *assets held by the fund*. Furthermore, Regulation 28(3(d) requires that "*a fund* must not invest or	See amended wording made to the Standard

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			contractually commit to invest in an asset, including a hedge fund or private equity fund, where the fund may suffer a loss in excess of its investment or contractual commitment in the asset. This does not preclude *a fund* from investing in derivative instruments subject to subregulation (7)". The emphasis should be on the *assets of the fund*. It is therefore suggested that the definition should be rephrased to refer to the fund's assets and not to "capital employed to an investment". It is also suggested that the reference to "securities" should be replaced with "assets" as "securities" is not a defined term and "assets" is consistent with the terminology used in Regulation 28. Proposed wording: "leverage" means the use of ~~securities~~ assets, including derivative instruments, short positions or borrowed capital to increase the exposure of the fund's assets beyond the ~~capital employed to an investment~~ value of the fund's assets, and for purposes of this standard "gearing" has the same meaning;	
26.	ASSA	Section 1, definition of "leverage"	We suggest the definition is expanded to make it clear that derivative exposure backed by appropriate assets as specified in the conduct standard will not constitute a leveraged position. Suggestion: "means the use of securities, including derivative instruments, short positions or borrowed capital to increase the exposure beyond the capital employed to an investment, and for purposes of this standard the	See comment above at item 25. Although the suggested definition is technically correct, for the sake of consistency and to simplify the definition, the FSCA prefers the definition proposed by ASISA

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			use of such securities where appropriate assets are held to cover the resulting exposure does not amount to leverage, and "gearing" has the same meaning;"	
27.	ASISA	Section 1, definition of "net effective exposure"	The November 2013 Draft Conditions defined net exposure to mean the effective economic exposure taking into account the offsetting of long and short positions, subject to paragraph 5. Paragraph 5 in the November 2013 Draft Conditions contained the requirements for Netting. ASISA members then suggested that the references should be to "effective economic *derivative* exposure" to "net *derivative* exposure", and "long and short *derivative* positions" to avoid confusion as it was used in the context of derivative exposure. Paragraph 2.3 of the Statement supporting the Draft Conduct Standard (issued on 8 June 2020) indicates that comments on the November 2013 Draft Conditions as well as the FSCA's responses are enclosed in the Schedule attached to this Statement. There is however no response document included in a Schedule and the FSCA reason for changing the defined term to "net *effective* exposure" and not accepting ASISA members' suggestion is unknown. Paragraph 2(2) of the Draft Conduct Standard refers to "net derivative exposure" (not a defined term in the Draft Conduct Standard) and in the context of this paragraph, ASISA members reasoned that the definition of "net effective exposure" was intended to refer to "net derivative exposure". It is therefore again suggested that the definition should be clarified by referring to derivative exposures and derivative positions. This will ensure that the meaning	See amended wording

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			of the term is correctly applied in paragraphs 5(1), 6(1) and 6(2) of the Draft Conduct Standard, subject to the amendments proposed to these paragraphs. The term is also used in paragraph 6(3) which ASISA members propose should be deleted. Effective economic derivative exposure is a defined term and should be referenced accordingly. Proposed wording: "net ~~effective~~ derivative exposure" means the effective economic derivative exposure taking into account the offsetting of long and short derivative positions;	
28.	BASA	Section 1, definition of "net effective exposure"	We recommend that the definition should be read with "*effective economic derivative exposure*;" regulation should ideally be clear around instrument level as opposed to portfolio level constructs; "long and short positions" can be interpreted very broadly.	Disagree, see amended wording and item 27 above
29.	Legae	Section 1, definition of "net effective exposure"	"net effective exposure" means the fund's effective economic exposure to an asset or asset class taking into account the offsetting of long and short positions and the effective derivative exposure;" Using the term "effective economic exposure" here may create confusion with the already defined term "effective economic derivative exposure". This defined term is used throughout the document as a reference to the fund's "assets" or "asset classes" as used in regulation 28.	See amended wording made to the Standard
30.	Futuregrowth	Section 1, definition of "reference assets"	Means the assets, or group of assets, or variables……	Agree, see amendments to the Standard

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31.	ASISA	Section 1, definition of “repurchase rate”	The definition is technically correct, but it is common market practice to refer to the repurchase rate as the rate at which the South African Reserve Bank lends to South African banks. It is unnecessary to include references to “regularly” and “from time to time”. It is suggested that the definition should be rephrased to improve the reading thereof. Proposed wording: “**repurchase rate**” means the rate determined by the South African Reserve Bank and at which the South African Reserve Bank lends to a South African bank ~~borrows from the South African Reserve Bank as determined regularly by the South African Reserve Bank from time to time~~;	Agree see amendments to the Standard
32.	FIA	Section 1, definition of “speculation”	There is a concern that the definition of "speculation" to include transactions involving unusual and considerable risk levels intended to take advantage of short-term market movement for commensurate levels of gain" would prevent legitimate sources of alpha generation from active management using derivatives with reasonable risk parameters. Clarity is therefore requested in this regard, although it is noted that possibly this form of active alternative investment management is included in the 10% allocation to alternatives and is not relevant for this submission.	Comment noted, the definition of speculation adequately addresses the comment
33.	ASISA	Section 1, definition of “swap rate”	The Statement supporting the Draft Conduct Standard does not contain any information that could assist with understanding the rationale for defining and thereby	Agree, see amendments to the Standard

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			restricting the use of a swap rate as the reference asset of a derivative instrument. The absence of an FSCA response to comments on the November 2013 Draft Conditions amplifies the uncertainty given that ASISA members in its submission thereon proposed the inclusion of a swap rate as a reference asset but did not propose that the term should be defined. Paragraph 16(2) of CISCA Board Notice 90 references swap rate in general and does not define "swap rate". If a specific swap rate is defined for pension funds, such funds will be precluded from investing in collective investment scheme portfolios (CIS portfolios) when the look-through principle in Regulation 28(4) is applied. It is uncertain whether the proposed specific definition incorporates all the swap rates agreed between the parties to an ISDA Agreement. Inflation linked swaps, total return swaps and currency swaps for example appear to be excluded. The definition seems unnecessarily restrictive and may preclude funds from investing in CIS portfolios if the look-through principle is applied. It is therefore suggested that the definition of swap rate should be deleted.	
34.	BASA	Section 1, definition of "value"	Clarification sought on definition: Is it notional value/premium/Mark to Market	Listed as well as unlisted (with unlisted subject to the necessary independent "valuation"/ "value" as defined)
2. USE OF DERIVATIVES INSTRUMENTS				
35.	ASISA	2(1)	Please refer to the comment above on the definition of "leverage". The definition should be amended to be consistent with its application in this paragraph	Agree, see amendments in the Standard

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36.	BASA	2(1)	In principle, we are in agreement. However, it is worth considering whether there is repetition in the Standard that is already covered by other legislation. For example, in principle, a fund can't leverage in terms of the Collective Investment Schemes Act (CISCA). However, for a Retail Investor Hedge Fund (RIHF) or Qualified Investor Hedge Fund (QHIF), you can. This falls under CISCA. In terms of CISCA, a Fund must be leveraged using the correct underlying assets. CISCA defines what is meant by the underlying cover assets or underlying equities. However, most Hedge Funds won't be covered by CISCA because they are operated in terms of Segregated Mandates. Board Notice 90 (BN 90) provides further detail on what you can and can't do with CISCA, including the guidance in terms of Regulation 28 under the Pension Funds Act (Reg 28). The most prudent measure is to ensure that there are reference assets when hedging. The investment consultant would ensure this.	Comment noted
37.	Eskom	2(1)	2(1) The fund does not and may not invest in derivative instruments for the purposes of speculation or to leverage the assets of the fund as in accordance with the fund's derivative policy. This Policy provides guidance on sound practices for managing the risks inherent in the use of derivative instruments.	Comment noted

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38.	IRFA	2(1)	Does this contradict investment into Hedge Funds? In other words, does this regulation exclude Hedge Fund investments. Hedge Funds will fail a number of the following provisions, e.g. 3(a)	Comment noted, this Standard does not exclude hedge fund investments. However, specific conditions for investment in hedge funds by pension funds is provided for in the draft Conduct Standard prescribing conditions for investment in hedge funds. A hedge fund manager must contractually undertake to disclose to the fund if the fund's exposure to embedded derivatives in the hedge fund exceeds one hundred percent of such derivatives.
39.	ASISA	2(2)	Please refer to the comment above on the definition of "net effective exposure". The definition should be amended to "net derivative exposure" to be consistent with the application in this paragraph. It is understood that this paragraph intends to provide generally, where derivative instruments are used, that the net derivative exposure (after long and short derivative positions have been offset) must be covered by appropriate assets in the fund. The appropriate assets could be reference assets as determined in paragraph 6(1) of the Draft Conduct Standard (e.g. for a short derivative position) or it could be cash (e.g. for a long derivative position). If the definition of reference assets is considered, cash cover for a long derivative position is not provided for in the proposed paragraph 2(2) in the Draft Conduct Standard. Paragraph 2(4) of the Draft Conduct Standard appears to intend to provide for a derivative position where cash is the cover for a derivative exposure. The Statement supporting the Draft	See response above at item 27. Synthetic cash not provided for as it implies "uncovered positions". Use of hedging provides much needed clarity. Offsetting long and short must be covered by reference set(s). Agree see amendments made to the standard. The FSCA is of the view that the drafting

			Conduct Standard does not contain sufficient information to assist with confirming the aforementioned interpretations. It is further confusing because paragraphs 2(2) and 2(4) seem to provide similarly, but they do not follow each other. ASISA members suggest that paragraphs 2(2) and 2(4) should be combined to clarify the regulatory objective of the paragraphs and to assist with interpretation. The regulatory objective is understood to be that generally, where derivative instruments are used, that the net derivative exposure (after long and short derivative positions have been offset) must be covered by appropriate assets (either reference assets or cash) in the fund. It is unnecessary to refer to "hedging" in this paragraph as it is included in paragraph (a) of the definition of "efficient portfolio management". Also, the incorrect reference to paragraph 5 should be replaced with a reference to paragraph 6(1). Proposed wording: Where a fund uses a derivative instrument for the purposes of ~~hedging and~~ efficient portfolio management, – *(a)* the net derivative exposure must at all times be covered by appropriate reference assets as determined in paragraph ~~5 below~~ 6(1) of this Conduct Standard; or *(b)* where appropriate, a fund must hold cash ~~assets underlying a derivative position~~ with a market value at least equal to the effective economic derivative exposure.	improvements made will enhance cost efficiency in the use of derivatives by pension funds. Further, the drafting improvements made give effect to the original regulatory intent. Agree, see amendments to the Standard. Paragraphs 2(2) and 2(4) have been combined Agree, see amendments to the Standard.

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40.	ASSA	2(2)	Change “net derivative exposure” to “net effective exposure of derivatives” to be consistent with the defined term.	Agree, see item 39 above and subsequent amendments made to the Standard
41.	BASA	2(2) “…the net derivative exposure must at all times be covered by appropriate reference assets”	Currently, some pension funds are invested into credit risk. Even if they do apply BN 90, they are investing in credit swaps. It would be relevant to define the underlying cover assets and how far down the credit risk spectrum this must go. ➢ It is important to ensure that net exposure is covered by the appropriate reference assets. ➢ Please can you clarify what is an appropriate reference asset? If a pension fund has a cash obligation, must the pension fund hold cash, or can the pension fund hold money market fund units, or other liquid assets? Please can you clarify what an appropriate reference asset would need to be when buying or selling options (including options on indices)? If a pension fund sells a call option on the Top40, must the pension fund hold Top40 shares or can the pension fund hold a highly correlated basket?	The Standard must be interpreted and understood in context, which is conditions for investment in derivatives by pension funds. The stated principle is that a net derivative exposure must at all times be covered by appropriate reference assets. It is impractical for the FSCA to define how far down the credit risk spectrum the fund must go Further, see comments made at item 39 as well as amendments made to the Standard
42.	Eskom	2(2)	The fund uses derivative instruments to manage downside risk (hedging), efficient portfolio management and as a way of implementing tactical decisions. Derivative instruments may be used for the following purposes: - Asset allocation - Hedging - Insurance - Yield enhancement	Noted

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			- Asset Disposal - Asset acquisition - Yield curve risk management - Transition management As defined in the Fund's derivative policy.	
43.	FIA	2(2)	This would not allow a fund to have any net long or short positions that are not covered by an appropriate reference asset i.e. all net derivative positions would effectively be a hedge. This doesn't allow for any active management, for the purposes of generating alpha for the fund, within reasonable risk parameters, by the FSP.	See comments made at item 39 as well as amendments made to the Standard. Long and short positions are allowed as long as such positions are covered positions
44.	IRFA	2(2) and 2(3)	Subparagraphs 2(2) and 2(3)(a) only speaks to hedging whereas we believe provision should also be made for long derivative positions	See response above at items 39 to 43. Long and short positions are allowed as long as they are covered positions and netting provisions are adhered to
45.	JSE	2(2)	It is our understanding that this sub-paragraph implies that a fund may not hold a derivative instrument unless the fund has an exposure to the underlying reference asset or assets (e.g. as a hedge 'covering' an underlying reference asset). It is necessary that a fund is able to enter into a derivative instruments to hedge against a number of risks (e.g. counterparty risk) without having exposure to underlying assets. This limitation would, for example, prevent a fund, (seeking to improve performance) from using a derivative to move into a position, or prevent a fund (seeking to protect capital or income) from using a derivative to hedge the fund's long dated liabilities (which could be in excess of 45 years), as government bond maturities seldom extend past 30 years.	Use of derivatives is restricted to limit losses to capital commitments of the fund and limited liability structures hence a fund must hold covered positions at all times The duration for debt instrument reference assets needs to be taken into account

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46.	Khumo Capital	2(2)	Hedging is defined as part of efficient portfolio management so can be taken out of this sentence, i.e. the sentence should read "Where the fund uses a derivative instrument for the purposes of efficient portfolio management, the net…".	Agree, see amendments to the Standard and comments above at item 39
47.	Khumo Capital	2(2)	This statement does not cover all types of derivatives utilised by pension funds. For example, if one goes long an equity index through a forward instrument or call option, the reference asset is the equity index, but the net derivative exposure is covered by cash type assets. We propose that this subparagraph be expanded to also include circumstances where investment is made into long derivative positions covered by cash type assets. Please also note that paragraph 5 does not address "appropriate reference assets", as referred to in this subparagraph.	See comments above at item 44
48.	Legae	2(2)	"Where a fund uses a derivative instrument for ~~the purposes of hedging and~~ efficient portfolio management, the net derivative exposure must at all times be covered by appropriate reference assets as determined in paragraph 5 below." The definition of efficient portfolio management already includes hedging. (Refer to the definition of "efficient portfolio management").	Agree, also see item 39 above
49.	PWC	2(2)	Does this mean that the net derivative exposure should never put the fund in a negative position?	Comment noted, in principle a fund should not be placed in a net short position. All derivative positions must be covered by the relevant reference assets. For more detail, please refer to the netting provisions in this Standard

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50.	Legae	2(2)	"Where a fund uses a derivative instrument for the purposes of hedging and efficient portfolio management, the ~~net~~ effective economic derivative exposure must at all times be covered by appropriate reference assets as determined in paragraph 5 below." Definition is "effective economic derivative exposure". The word "net" can be deleted as long as it is made clear that the term "effective economic derivative exposure" already refers to net derivative exposure per the definition suggested earlier.	See amended wording "net" has been deleted for clarity
51.	Legae	2(2)	"Where a fund uses a derivative instrument for the purposes of hedging and efficient portfolio management, the net derivative exposure must at all times be covered by appropriate ~~reference~~ assets as determined in paragraph 5 below." "reference asset" refers to the asset(s), or variable(s) from which the value of a derivative is derived. The assets that are referred to here may not be the "reference asset", but the assets that are held by the fund. (Refer paragraph 6 (Netting) where "identical or similar assets" are required.)	Disagree, the FSCA is of the view that the word "reference asset" must be retained. This is important in the context of the look though principle being applied in terms of Regulation 28(4)
52.	Legae	2(2)	Where a fund uses a derivative instrument for the purposes of hedging and efficient portfolio management, the net derivative exposure must at all times be covered by appropriate reference assets ~~as determined in paragraph 5 below~~. Paragraph 5 does not discuss appropriate underlying assets. Paragraph 5 covers in subparagraphs	Agree, see comments above at item 41

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			(1) the regulation 28 exposure calculation (2) calculation of counterparty risk	
53.	RiskCura	2(2)	The words "**hedging and**" should be removed. Hedging is included in the definition of "efficient portfolio management".	Agree, also see item 41 above
54.	RiskCura	2(2)	Paragraph 5 does not address "appropriate reference assets", and we suggest that this reference be removed.	Disagree, see comments above at item 49
55.	RiskCura	2(2)	One of the strategies that pension funds use for efficient portfolio management is derivatives which are covered by assets other than the reference assets of those derivatives. As an example, entering a long forward on an equity index (the reference asset), which is covered by a cash type position. We propose that this paragraph is amended so that the words "covered by appropriate reference assets" are replaced with "covered by appropriate assets"	"Reference asset" is crucial to ensure covered positions and netting provisions are complied with
56.	Sentinel	2(2)	Efficient Portfolio management may involve adjusting strategic asset allocation in order to take advantage of short-term price anomalies, where it may be too costly and time consuming to sell and buy physical assets. This clause does not make provision for this scenario, i.e. a long position in a derivative to add exposure to a specific asset class (covered by cash).	Comment noted, however FSCA is of the view that no synthetic cash is allowed as it implies "uncovered positions". Also see comments made at item 39 as well as amendments made to the Standard
57.	Sentinel	2(2)	The reference to Paragraph 5 seems to be incorrect, since paragraph 5 does not make any mention of determination of appropriate reference assets	Agree, amendments made to the Standard
58.	ASISA	2(3)(a)	The absence of an FSCA response document to comments on the November 2013 Draft Conditions makes it very difficult to formulate an appropriate	Disagree, paragraphs 2(3)(a) and (b) addresses two issues i.e., derivative **exposure** and

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			response to this proposed paragraph. In addition, the Statement supporting the Draft Conduct Standard does not contain sufficient information on the regulatory objective or rationale for the proposed requirements in paragraph 2(3). Subparagraphs (a) and (b) appear to address two different concepts in the same paragraph. This is confusing and complicates interpretation. ASISA members considered the wording against the similar wording and context in previous Drafts of Conditions and reasoned that the specific reference to "asset class" in subparagraph (a) means that it seeks to ensure that derivative exposures are taken into account in the asset class/category to which the derivative exposure relates and that such exposure may not exceed the value of the reference assets in that asset class/category. The reference to "hedge" in this subparagraph is not understood as hedging is defined and included in the definition of efficient portfolio management. It is submitted that paragraphs 2(2), 5(1) and 6(1) achieves the same outcome; i.e. derivative exposure must be covered (paragraph 2(2)), a fund must ensure that the calculation of assets *and categories of assets* includes the derivative exposures (paragraph 5(1)) and in calculating compliance with the limits in regulation 28, the exposure of the assets, *and categories of assets*, must be netted with the derivative exposures where the reference asset is identical or similar to the fund's assets (paragraph 6(1)).	maximum on the **value** of all derivatives. Also see comments at item 65 below

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			It is therefore proposed that subparagraph (a) should be deleted. It is unnecessary duplication that causes confusion as the intended regulatory objective or outcome (as understood by ASISA members) is provided for in paragraphs 2(2), 5(1) and 6(1) of the Draft Conduct Standard.	
59.	BASA	2(3)(a)	Clarification is sought how this rule should be applied in respect of an index or a basket of underlying securities?	The Regulation 28 look through principle applies and weightings
60.	FIA	2(3)(a)	States "derivative instruments per asset class held by a fund may not exceed the value of the reference asset that the derivative seeks to hedge". However, in the definition for "efficient portfolio management" section (c) allows for "the generation of additional income for the fund, with a risk level consistent with the fund's investment policy statement." Thus an unhedged, net exposure (long or short), which does not breach Section 5, aimed at generating alpha for the fund, within reasonable risk parameters should be permitted.	Long and short are allowed as long as they are covered positions
61.	JSE	2(3)(a)	With reference to our comment (1) above, this sub-paragraph reinforces the implication in sub-paragraph 2(2) and would prevent a fund, per our second example, from entering into an interest rate swap to match the maturity dates of the funds liabilities.	We consider this as exceptional circumstances, for example interest rate swaps for LDI investments in pensioner portfolios
62.	Khumo	2(3)(a)	This only speaks to hedging strategies, e.g. an equity hedging strategy where the reference asset is an equity index. It does not cover other types of efficient portfolio management strategies, e.g. if you purchase a long forward or call option position on an equity	Please refer to the definition of reference assets which includes group of assets or indices. Also please refer to item 68 below as well as the amendments made to the Standard

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			index, the equity index is the reference asset, but the derivative exposure is covered by an investment in cash type assets. We propose that this subparagraph be expanded to also include circumstances where investment is made into long derivative positions covered by cash type assets.	
63.	Legae	2(3)(a) and (b)	Subparagraph (a) and (b) of paragraph 2(3) addresses two issues. Subparagraph (a) places a maximum on the "<u>effective economic derivative **exposure**</u>" Subparagraph (a) places a maximum on the "<u>**value** of all derivatives</u>" **Proposal:** Split subparagraph (a) and (b) into two paragraphs 2(3) and 2(4) "2(3) The maximum effective economic derivative exposure of derivative instruments per asset class held by a fund may not exceed the value of the reference asset that the derivative seeks to hedge." "2(4) The value of all derivative instruments held by a fund may not exceed 25% of the value of the fund's assets."	Agree, see amendments to the Standard See comments below at item 70, and in line with other comments, the limit has been removed from the Standard
64.	Legae	2(3)(a)	"2(3) The maximum effective economic derivative exposure of- *(a)* derivative instruments per asset class held by a fund may not exceed the value of the ~~reference~~ asset that the derivative seeks to hedge;"	Disagree, FSCA's view is to retain the wording "reference asset" to ensure covered positions at all times. Also see comments above at item 41

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			"reference asset" refers to the asset(s), or variable(s) from which the value of the derivative is derived. The asset that are hedged and measured in terms of paragraph 2 (3) (a) may not be the "reference asset", but is the asset that are held by the fund. (Refer paragraph 6 (Netting) where "identical or similar assets" are required.)	
65.	Sentinel	2(3)(a)	This clause only speaks to hedging strategies. No provision is made for other forms of efficient portfolio management, where the reference asset may be cash (i.e. long position as described above)	See above where hedging or cost efficiency cannot be demonstrated it will be regarded as speculation
66.	RisCura	2(3)(a)	Please confirm that this clause is only applicable when hedging, and not the case for points b and c under the definition of efficient portfolio management?	It is applicable to both (b) and (c) as well
67.	Aeon	2(3)(b)	*Under:* ***The maximum effective economic derivative exposure of:*** *b) The value of all derivative instruments held by a fund may not exceed 25% of the value of the fund limit of 25% of the value of assets.* **Commentary**: Should the fund wish to implement larger hedges over the portfolio, i.e. Naspers (JSE code: NPN) and Prosus (JSE code: PRX), this may pose an issue regarding effective risk management.	See response below at item 68
68.	ASISA	2(3)(b)	Section 98(1)(a)(ii) of the FSR Act provides that a regulatory instrument may not be made unless the maker publishes a statement explaining the need and	The Authority recognises that there is a role for the use of derivatives within pension funds' portfolios, however there are a number of major risks

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			the intended operation of the regulatory instrument. ASISA members believe that the Statement supporting the Draft Conduct Standard fails to meet the obligation set out in section 98(1)(a)(ii) of the FSR Act, especially with regard to paragraph 2(3)(b) of the Draft Conduct Standard. The Statement merely highlights certain risks generally and indicates that the benefit of using derivatives must be balanced with the possible associated risks. It further states that conditions are set to, among others, determine maximum allowable economic derivative exposure limits. The Statement does not sufficiently explain the rationale for setting a limit and does not provide any information on the basis for deciding on a 25% limit on derivative exposures. The absence of an FSCA response to comments on the November 2013 Draft Conditions amplifies the uncertainty and hampers the formulation of an appropriate response to the proposed limit. The proposed paragraph refers to the “value” of derivatives. The meaning of “value” is not clear. It was presumed that the intention was to limit the “exposure” of derivatives. In its submission on the November 2013 Draft Conditions, ASISA members commented that a limit on derivative exposure is unreasonably restrictive and even more so if the use of derivatives is restricted to a certain purpose and if derivatives are required to be covered. There are many entirely reasonable strategies employed by funds that will cause a breach	inherent in these instruments. Accordingly, the Authority agree with the proposal to remove the limit on derivatives exposures by pension funds

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			of the proposed limit. If the look-through principle set in Regulation 28(4) is applied, a fund will be precluded from investments in CIS portfolios or insurance policies as these regulated products are not subject to a similar limit on derivative exposures. A seemingly arbitrary limit, in addition to all the requirements, entity limits and asset class limits relating to a fund's investments as set out in Regulation 28 and Table 1, the totality of the conditions set in the Draft Conduct Standard and the regulatory frameworks applicable to exchanges, financial services providers, OTC derivative providers, CIS management companies, CIS portfolios, insurers and insurance policies, does not appear to be balancing the benefit of using derivatives with the possible associated risks. A standardised limit across all funds disregards the differing asset-liability profiles of funds. It appears as if the differing contexts of different funds were not considered in proposing a limit. Funds could effectively be prevented from carrying out its fiduciary duty to act in the best interest of its members by responsibly managing the assets of the fund if a fund is restricted in its adoption of a responsible investment approach to deploying capital into markets that will earn adequate risk adjusted returns suitable for the fund's specific member profile, liquidity needs and liabilities, as is required by Regulation 28. It is conceivable that a fund may have to choose between assets or categories of assets when deciding on the use of derivatives, e.g. if a fund hedges 25% of its 30%	

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			foreign exposure, no other asset or asset class could be hedged. In response to an ASISA enquiry, the FSCA indicated that it cannot allow the entire balance sheet of funds to be eroded by derivatives when something goes wrong; that the limit could be relaxed at a later stage after the FSCA has assessed funds' compliance with the Conduct Standard over a period of time; that the FSCA has seen some funds offsetting uncovered positions against their cash which is then reflected as synthetic cash; and that while this practice persists, a limit is required. The FSCA considered the OECD/IOPS (International Organisation of Pension Supervisors) guidance on pension funds' use of alternative investments and derivatives. ASISA members considered the aforementioned FSCA feedback and respectfully submit that the FSCA should consider the regulatory control framework for pension fund investments on a holistic basis. The overarching requirements set in Regulation 28 (for example responsible investment; assets to be appropriate for liabilities, due diligence before making investments, risk analysis and understanding changing risk profiles), the limits applicable to entities/issuers and asset categories set in Table 1 to Regulation 28 and the risk management requirements envisaged by the Draft Conduct Standard (for example restricted use, consistency with investment policy, cover, valuation, risk management policy,	

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			restricted counterparties and reporting) adequately controls exposure to derivatives. The prevalence of funds offsetting uncovered positions against cash is unknown and considering that there are currently no conditions for derivatives (or guidance/direction on required cover), it is respectfully submitted that the FSCA should take enforcement action against these funds if they were irresponsible in carrying out their fiduciary duties and not consider an example of a few as a proxy of the entire fund universe. The OECD/IOPS guidance indicates that a supervisor may include limits (it is not an obligation) but it also guides on considering the principle of proportionality in regulation, i.e. regulation must be proportional to the intended objective/outcome and proportional in the context of the universe of regulated entities. A retirement fund has a long investment horizon and an undisputed need to meet a determinable set of future liabilities and must be able to benefit from the use of derivative instruments within a risk management framework designed in the context of a specific fund. ASISA members strongly suggest that there should be no limit on derivative exposure and that paragraph 2(3)(b) of the Draft Conduct Standard should be deleted. The following is reiterated in support of the suggested deletion:	

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			• The limit is unreasonably restrictive and may negatively impact the responsible management of a fund's assets. • A fund will be precluded from investing in CIS portfolios and insurance policies as these regulated products are not subject to similar limits. • The proposed limit is not proportional and differing asset-liability profiles of funds are disregarded. The overarching requirements for the management of a fund's assets (including limits per entity/issuer/asset category) set out in Regulation 28 in conjunction with the risk management requirements envisaged by the Draft Conduct Standard, adequately controls exposure to derivatives.	
69.	ASSA	2(3)(b)	The wording confuses the concepts of the value of a derivative and the exposure of a derivative. It is not clear what is meant by the reading of the clause together with the heading, being "The maximum effective economic derivative exposure of (b) the value all derivative instruments held by a fund…" Suggestion: Separate out 2(3)(b) from the heading of 2(3) into a new clause, i.e. a new 2(4). The wording could then remain: 2(4) "The value of all derivative instruments held by a fund may not exceed 25% of the value of the fund's assets".	Agree, see amendments to the Standard. Also see comments above at item 68
70.	BASA		Clarification is sought how pension funds would be expected to calculate their exposure in respect of	Full look through applies on CIS and linked policies (it was merely a *reporting exclusion*

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			products that are a combination of equity/debt and an embedded derivative(s)? What is the practical requirement for a limit of 25% as in some instances the investment strategy could utilise derivatives to achieve a desired payoff profile or gain exposure to an asset class and therefore be appropriate for a pension fund at a broader level with a higher than 25% allocation. (For example, a managed fund utilising capital protected notes with some upside to another asset class (equity) you could provide a conservative portfolio with capital preservation and therefore the pension fund may want to utilise more than 25% exposure thereto. The risk could be managed through the implementation of the type of assets, spreading of counterparty exposure, margining and collateral and by ensuring no leverage is utilised in the fund). Pension funds use derivatives to invest in an underlying asset class as opposed to purchasing the underlying outright, which didn't necessarily result in the pension fund being leveraged but may have been used as a more efficient and cost effective way to invest/transact (e.g. index future as opposed to buying all the underlying constituents with same net exposure but potentially cheaper transactional costs). It is important to be clear about how "the value of the fund's assets?" is calculated. This also relates to what the definition of a derivative instrument is". 25% of	however see proposed changes to regulation 28 removing the reporting exclusion. Also see netting provisions See response above at item 68 See comment above at items 60 and 68

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			what? Gross value of the fund, or the net value, or the covered value? If you define value as the nominal value of the position, it might be severely restrictive. Additionally, a hedge would have a certain value on day one, but would accrue value over time. Viewed in this light, 25% seems problematic. In some instances, it may be viable to put a hedge over the entire fund, or hedge all your equity exposure, for example. In these cases, 25% is too low) - Using the net realised value of all derivative instruments as a limit would be be better than a hard 25%, which might have unintended consequences forcing investments managers to make decision they may not want to take) Clarification is sought on the following: in Reg28 if you issued a non-linked policy to the pension fund you would not be subject to same limits and look-through, how does the new legislation cater for this component where look through and derivatives are utilised. Historically you could issue a non-linked policy for example 100% capital guarantee with equity upside and this would not count in same manner. The pension fund would have a guarantee from the issuer entity and therefore not be limited by derivatives, counterparty exposure etc. Would this still be permissible?	In the case of guaranteed policies, the statutory actuary certification applies in terms of Regulation 28

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71.	Eskom	2(3)(b)	What is meant by the "value" of all derivative instruments, and how is this calculated. This could be the "net economic effective exposure of derivative instruments" or "gross economic exposure of derivative instruments"	See response above at items 65 and 68
72.	Eskom	2(3)	The maximum effective economic derivative exposure of- (a) Derivative instruments per asset class held by the Fund do not exceed the value of the reference asset that the derivative instrument seeks to hedge. Derivative positions on individual counters must be fully covered by the underlying investments as stipulated in the derivatives policy. The value of all derivative instruments held by the Fund do not exceed 25% of the value of the Fund's assets	Noted
73.	FIA	2(3)(b)	For clarity please confirm that, the "value of all derivatives instruments held by a fund" would be the "net effective exposure".	See comments above at items 60 and 68
74.	IRFA	2(3)(b)	We would like to request that this paragraph is removed. The reason for this request is: A retirement fund has a long investment horizon and an undisputed need to meet a determinable set of future liabilities and must be able to benefit from the use of derivative instruments within a risk management framework. We therefore strongly suggest that there should be no limit on derivative exposure and that paragraph 2(3)(b) of the draft Conduct Standard should be deleted. The	Agree, see comments above at item 60 and 68 as well as amendments made to the Standard

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			limit is unreasonably restrictive and may negatively impact the responsible management of a fund's assets. Furthermore, a fund will be precluded from investing in CIS portfolios and insurance policies as these regulated products are not subject to a similar limit (bear in mind that look-through will be applied as required by regulation 28).	
75.	JSE	2(3)(b)	It is not clear whether the term 'value of all derivative instruments' is intended to mean 'premium value of all derivatives' or 'notional value of all derivatives'. If the drafter's intention is that the term should be interpreted as 'notional value of all derivatives', we have significant concerns regarding the ability of funds to achieve efficient portfolio management; a 25% 'notional value' limit would severely constrain a fund's ability to prudently manage the performance and preservation of the assets of the fund. In addition, a 'notional value' limit would negatively impact the activity in exchange-traded derivatives markets and the liquidity underlying asset class, as part of underlying asset activity is related to derivative trades and the management thereof by the providers of markets/pricing in derivatives.	See response above at item 60 and 68 and amendments made to the Standard
76.	Khumo Capital	2(3)(b)	We believe this restriction should be removed. It will, for example, prevent risk-averse funds, or funds with most members close to retirement, from investing in very conservative, capital protected investment strategies. These strategies can, for example, be constructed by investing the majority of the assets (90% to 95%) in fixed rate money market instruments (ensuring, say, 100% capital protection over a 1-year	Agree, see comments above at item 68 and amendments made to the Standard

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			period) with the remainder invested into call options providing upside market exposure in different asset classes. The effective economic exposure of the options can easily exceed the 25% limit should market performance be positive over the 1-year period. If market performance is negative after the 1-year period, the options expire with zero value and the predetermined growth in the money market instruments ensure that the member receives their initial capital invested, i.e. their capital is 100% protected over the term, even if there is a significant market correction. The dual objectives of these types of strategies are to provide explicit capital protection as well as protecting the real value (relative to inflation) of the members' assets through exposure to positive market movements. We believe these types of conservative strategies play an important role in the retirement environment. From a market risk perspective, the member only participates in positive market movements. From a counterparty exposure risk perspective, the money market instruments (where the majority of the fair market value sits) and call options are split between the appropriate number of issuers. A reporting framework, as discussed in our comments to paragraph 5, addressing both the asset class risk (effective economic exposure of derivative) and counterparty exposure risk (fair value of derivative) negates the need for this additional 25% limit.	
77.	Mergence		We believe the proposed limit on the maximum effective economic derivative exposure not to exceed	Agree, please see comments above at item 68

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			25% of the fund's assets to be overly restrictive and may disallow a number of appropriate, low risk investment products and strategies offered by fund managers to pension fund clients. While this regulation is being applied at pension fund level, our practical experience is that some pension funds require by mandate each of their underlying fund managers to ensure compliance with Regulation 28 at the product level thereby ensuring compliance at the aggregate pension fund level. The result being that this regulation may practically limit the scope of investment at product level, even if, when aggregated up to pension fund level the regulations are not breached. We do believe that there are valid investment strategies that this limit would disallow. Consider for example a fund management product that allocates 50% of its assets to fixed income and cash and the remaining 50% to domestic equity. But due to liquidity and lower trading costs, the equity position is obtained through index futures. This portfolio has exactly the same risk and return characteristics as a balanced fund with a 50% direct allocation to equities. The former fund would have a 50% effective economic exposure to derivatives, given the delta of the index futures position of 1, breaching the proposed limit in question. Another example would be a fund that allocates 50% to fixed income and cash and 50% to equity, but with the addition of a collar structure overlaid on the equity allocation. The fund would purchase index equity put	

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			options with a notional exposure of 50% of the fund and sell index equity call options of the same notional. This collar structure would serve to reduce the risk of the original portfolio. In the event of a sharp fall in equity markets the effective economic interest of the collar structure could drop below -25% of the fund total assets. While this would serve to protect the value of the fund's assets, the fund would fall foul of the limit in question. We believe that the remainder of the conduct standard ensures prudent use of derivatives and is sufficient to protect against the risks of over-leverage or misuse of derivatives without this additional constraint.	
78.	PWC	2(3)(b)	Does this also include foreign assets?	See comments above at item 68
79	PWC	2(3)(b)	States that "the value of all derivative instruments held by the fund may not exceed 25% of the value of the fund's assets" What "value" is being referred to here? The Market value or the economic effective exposure?	The restriction has been removed from the Standard. See comments above at item 68 and amendments made to the Standard
80.	RisCura	2(3)(b)	We propose that this restriction be reviewed, specifically when looking at long only positions that have sufficient cover of appropriate cash type assets	See comments above at item 68
81.	Sentinel	2(3)(b)	This clause does not cater for capital guarantee funds, where the underlying exposure to derivates far exceeds 25%. The value of derivative instruments is also different from the effective economic exposure of the instrument.	See comments above at item 68

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			It would appear this clause refers to fair value, whereas clause 2(3)(a) refers to effective economic exposure.	
82.	ASISA	2(4)	Please refer to the comment above on paragraph 2(2). Paragraph 2(4) of the Draft Conduct Standard appears to intend to provide for a derivative position where cash is the cover for a derivative exposure. ASISA members believe that paragraph 2(4) should be combined with paragraph 2(2) as both paragraphs appear to require that net derivative exposure must be covered by appropriate assets in the fund. The combination of the paragraphs will clarify the regulatory objective and assist with interpretation.	See response above at item 60 and the proposal to merge paragraph 2(2) and 2(4)
83.	Futuregrowth	2(4)	We would suggest deleting this section as, in our opinion, it is repetitive due to 2(2) as a position must always be covered by appropriate Reference Assets	Agree with the comments. Also see above comments at item 68 and 80
84.	Eskom	2(4)	Taking netting into account, if one has a net long exposure to a reference asset, what assets are required to be held to cover this exposure? This is left open. Is there no Assets In Liquid Form concept for such cover?	Covered positions at all times with no residual risk after netting (long and short positions)
85.	JSE	2(4)	Please see our comments 1 and 2 above. This sub-paragraph implies that derivatives may only be used for protection of underlying assets and does not allow for using derivatives to enhance the performance of a fund, by using a derivative to move into a position or expressing directional view. For example, buying an ALSI future (a highly liquid instrument) to express a broad market view is an effective and efficient (timing and cost) way to get exposure to the equities market	See comment above on interest rate swaps at item 41

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			without having to purchase each underlying stock constituent to achieve the same exposure. Although the fund may not hold the underlying assets (stocks) in this example, it would still meet two of the objectives set out in the definition of 'efficient portfolio management'; provided that the risk level is consistent with the fund's investment policy statement.	
86.	BASA	2(5) and (6)	We recommend, if pension funds don't build their own valuation methodologies that they be allowed to trade with entities that have regulator approved market risk frameworks, e.g. banks? In such situations they should be permitted to accept market risk and valuation data from the counterparty.	See response above at item 68. The Authority is of the view that there are existing accepted norms and valuation methodologies for derivatives both locally and internationally
87.	BASA		Clarification is sought: Is a Fund required to get an independent valuation at least monthly or is it acceptable that the instrument is of such a nature that an independent valuation could be obtained if required? Obtaining independent valuations may be quite an onerous responsibility on both the Fund and the Counterparty and would introduce additional fees/cost for the Fund	See response above on amended wording. See various valuation methodologies available for derivatives
88.	BASA		Clarification is sought: What would be the resolution process, should a dispute arise between the valuation as calculated by the OTC Derivative Provider and an independent valuation?	Disclosure of methodology in accounting framework for funds must be applied
89.	Aeon	2(5)(b)	*Under clause:* ***The use of derivative instruments by a fund must -***	See comment below at item 90.

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			b) take into account the fund's liquidity risk in both stressed and unstressed market conditions. **Commentary:** This will be difficult to assess as parameters would need to be provided to test the various market conditions. Furthermore, market conditions are evolving and changing, such as classifying this may be difficult.	
90.	FIA	2(5)(b)	How do you determine stressed and unstressed market conditions?	The words "stressed" and "unstressed" has different interpretation depending on various professions and context e.g. actuarial, accounting, legal and economic contexts. The FSCA view is that in the context of the Standard this essentially means the use of derivative instruments by a fund must take account the fund's liquidity risk in different market conditions i.e. it must take into account conditions for a bull market or a bear market and recessionary conditions.
91.	IRFA	2(5)(b)	Could you please provide clarity on whether the liquidity objectively is measured per fund? Especially in the 'stressed and unstressed' conditions. We would propose that the liquidity is measured objectively to show compliance.	Liquidity risk must be considered by a board of a pension fund in terms of Regulation 28 principle 6, 7 and 8
92.	ASSA	2(5)(c)	For OTC derivative transactions entered into directly between the fund and a counter party bank, it will in practice be an onerous and costly requirement to obtain an independent third party valuation of the derivative instrument (in the current absence of established central clearing houses for OTC	Agree see amendments made to the Standard as well as the revised sub-paragraph 2(4) of the Standard.

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			instruments). It is a well established current market practice to obtain these valuations directly from the counter party bank. Note that the fund remains at liberty to obtain third party valuations should they deem this to be necessary to satisfy the "reliable" and "verifiable" requirements, but should not be compelled to do so in the absence of concerns in this regard. Suggestion: Delete the word "independent".	
93.	BASA	2(5)(c)	Independent valuations should be done daily not monthly - this will allow risks to be properly monitored/managed.	See response above at item 92 on amended wording. See various valuation methodologies available for derivatives. Also see revised sub-paragraph 2(4) of the Standard.
94.	Eskom	2(5)(c)	The fund has investments in Equity Linked Notes to satisfy our allocation targets as per our Investment Policy. The fund wishes to clarify whether the FSCA considers these investments derivatives or not. Although the bank invests in derivatives to achieve the desired exposure, our contract with the Bank is fully funded and the payoff profile depends more on the credit risk of the Bank than the underlying instruments. 2(5) The use of derivative instruments by the Fund are- (a) Consistent with the fund's investment policy statement through the derivative policy document. (b) Taking account of the fund's liquidity risk in stressed and unstressed market conditions through traded size. The fund is also very liquid	Noted

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			with an allocation of 2% of the total fund invested in cash. (c) Subject to reliable, independent and verifiable valuation at least monthly – for fund uses daily reporting from the exchange. All derivative instruments the fund invests satisfy this point.	
95.	Futuregrowth	2(5)(c)	"Independent" should be defined under section 1, to mean independent from the Fund	See amendments to the Standard and response above at item 92
96.	BASA	2(5)(d)	Clarification is sought by what is meant by *"held directly by the fund"*? - Does this requirement not apply when an asset manager is trading with an ODP/bank/AU on behalf of a pension fund? Considering s2(6)(a) and (b) would appear that it doesn't apply which we would agree is the correct approach.	See amendments to the Standard and comments below at item 98 below, the wording "held directly by the fund" has been deleted
97.	Futuregrowth	2(5)(d)	It is our suggestion that the selling, liquidation or closing out of a position must be at the initiative of the Discretionary FSP appointed by the Fund, in terms of a mandate.	See amended wording to the Standard
98.	JSE	2(5)(d)	Clarity is required regarding what would constitute within a reasonable time in respect of exchange-traded derivatives and OTC derivatives. We note that certain OTC derivative instruments are not liquid and are not able to be sold or netted. For example, interest rates swaps cannot be sold; they terminate (i) on expiry (mature); (ii) when compressed; or (iii) when cancelled by mutual agreement with the issuer which	Reasonable time must be understood in the context of the Standard as well as rules of interpretation. Where a word has not been defined in a legal instrument, the general rule is that the ordinary grammatical meaning of the word must be applied, unless such an approach will lead to absurdity. What would constitute a reasonable time will depend on the circumstances and judgement will have to be exercised

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			may be costly and could incur early termination penalties.	
99.	Legae	2(5)(d)	"be able to be sold, liquidated or closed out within a reasonable time to enable effective closure of the position, at the fund's initiative ~~where the derivative Instruments are held directly by the fund~~." All derivatives are always held directly by the fund and should comply with this liquidity provision irrespective of the decision-making party to invest.	The Authority agrees with deletion as it is for hedging and efficient portfolio management purposes not an asset itself on balance sheet
100.	PWC	2(5)(d)	Provide guidance on "reasonable time"	See comment above at item 98
101.	Eskom	2(6)	The fund only uses a derivative instrument where there is a consistent, transparent and verifiable methodology to value the derivative instrument, which methodology must be implemented, monitored and periodically reviewed. For listed derivatives the ESKOM relies on the JSE valuations and checks reasonability at maturity and for ELNs, the ESKOM relies on the counterparty(bank) and checks reasonability monthly and checks the exact figure at maturity and for ELN all derivative instruments including OTC instruments are priced independently – listed derivatives are valued by the JSE derivatives system, as a third party. OTC ELNs are valued by the counterparty, checked monthly according to the agreed formula and verified exactly on maturity.	See response above at item 92, we have removed reference to "independent" valuation and replaced with verifiable, reliable and accepted valuation methodology
102.	IRFA	2(6)	A periodic audit must be done across all derivatives use. This is quite arduous and would have to be seriously considered.	The periodic audit is part of annual audited financial statements of funds

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103.	BASA	2(6)(a)	Valuation process. Clarification is sought whether this can take place within the asset manager if it is done by another area within the asset manager which is not involved in the investment committee/decision making process? Ref: *"third party"*.	This must be done by an independent third party not by an area within an asset manager. In that case it cannot be said that this is an independent third party
104.	Legae	2(6)(a)	"that ~~for when~~ a financial services provider ~~or OTC derivative provider~~ which is mandated to make the investment on behalf of the fund values the derivative, taking into account that the valuation process should take place independently from the investment management decision-making function of the financial services provider ~~or OTC derivative provider~~; or " An OTC derivative provider is a counterparty and cannot have mandate to make an investment on behalf of a fund. The requirement is that the financial services provider needs to provide an independent valuation for the fund.	Disagree, with the comments no amendments made to the Standard. This is applicable to also ODP's and direct investment side
105.	ASSA	2(6)(b)	Per the argument in the previous point, suggestion: Delete the words "independent third".	Disagree with this comment, wording retained. In the previous comment the wording was "independent third party" was removed in the context of an "OTC derivative provider". In this context the requirement is that if a derivative is not valued by a financial services provider then it must be independently valued
106.	BASA	2(6)(b)	Clarification is sought: "…*the valuation must be done by an independent third party*" – when is this valuation envisaged? Pre the execution of the derivative transaction or per subsection (5)(c) on a monthly basis?	See comments above at items 92 and 105

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107.	Legae	2(6)(b)	"~~where the fund Invests into a derivative instrument directly,~~ that the valuation must be done by an independent third party that adopts a consistent and transparent process for the valuation." The requirement is that if a derivative is not valued by a financial servicesprovider then it must be independently valued irrespective of the methodology of investment	Disagree, no amendments made to the Standard. This is applicable also to ODP's and the direct investment side
108.	Futuregrowth	2(6)(b)	Agree for listed derivatives. This could be impractical on OTC instruments. Clarity is needed as to which entity or entity type would perform the independent functions as these would need to be separate from the FSP and OTC derivative provider.	Agree, see response above at items 92 and 101 regarding the wording "independent"
3. GENERAL				
109.	Eskom	3(1)	3(1) The framework for risk management is set through the investment policy statement. The fund has a risk budget framework which is a process of measuring, allocating and controlling risk of the individual components (asset classes, individual funds, strategies and even instrument types) in the context of maintaining an overall risk limit for the aggregate investment portfolio and how derivatives can be used for the Fund's investment portfolio.	Noted
110.	PWC	3(1)	Section does not specify how often policy must be reviewed. Or is this covered in par 3(2) "on going basis"	Risk management policy must be reviewed on an ongoing basis and at least annually. Also see comment below at item 111
111.	ASSA	3(2)	The word "continuously" could be interpreted as requiring real-time intra day monitoring of derivative valuations, which would be very onerous (this is not	Agree, see amendments to the Standard

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			required of any other asset class or investment) and require very costly system upgrades. Suggestion: Replace “continuously” with “regularly”.	
112.	Eskom	3(2)	The board is made aware of all investments (including derivative instruments) the fund participates in through sub committees of the board which approve or reject investment recommendations of significant magnitude	Noted
113.	BASA		We note that the non centrally cleared (standardised) OTC derivative limits are large and that it appears that the EUR/USD limits have simply been converted at into ZAR at a undefined exchange rate. We would recommend that the South African position is based after polling practioners for actual numbers.	The Authority will consider excluding non-centrally cleared OTC from use by retirement funds depending on current derivative exposures held by funds
114.	BASA		We recommend that it is considered in this regulation that apart from hedging, funds may also want to use derivatives to obtain synthetic exposure. The economic exposure reference should be made with reference to maximum allowable allocation to a specific asset class or asset as defined in the mandate of the fund; rather than asset relative to derivatives exposure.	Synthetics can be indicative of uncovered positions and may cause funds to be over-extended in terms of limited liability investments
115.	BASA		We recommend that reasonable time periods for liquidation should be guided on; this should be with reference to the underlying liquidity requirements of the fund	See response above on liquidation
116.	Eskom	3(3)	The Board has appointed the Strategic Investment Committee to monitor the investment risk of the Fund in accordance with its investment objectives and	Noted

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			strategy of the Fund, subject to the relevant statutory requirements.	
117.	Futuregrowth	3(3)	Agree with clause. We believe that where the board lacks the necessary skills, its must in addition obtain investment advice.	Noted
118.	Aeon	3(4)(a) and (b)	*Under**: A fund must ensure that –*** *a) It is fully aware of all the fees and costs, including commissions and premiums, associated with the trading of derivative instruments, including those fees and costs which may be netted off the returns of derivatives; and* *b) all fees and costs, including commissions and premiums, are reported to the fund in a transparent clear and understandable manner* **Commentary:** May impact of Effective Annual Cost (EAC) and Total Expense Ratio (TER) and Total Investment Charge (TIC) disclosure. Need for the standardised format to disclose associated costs and fees in each fund.	The onus is placed on the fund and the board of a pension fund to ensure that it is fully aware of all the matters prescribed in this Standard as well as paragraph 3
119.	Eskom	3(4)(a)	Where the counterparty includes certain fees within the quoted price, does the FSCA require the counterparty to report these fees? 3(4) Most commissions are included in the price but can be disclosed, as they are charged as standard by the brokerage community. The new JSE ITaC requires transparency of the commission, which is dealt separately to reports about the daily mtm.	Fees must be disclosed to assess cost efficiency

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			4. COUNTERPARTIES	
120.	Aeon	4	Does this include foreign counterparties with equivalent regulation?	Yes, both local and foreign counterparties are included with equivalent regulation
121.	BASA	4	We recommend that this section should clarify that only licensed ODPs may sell/issue OTC derivatives to pension funds in South Africa (the broad language may be construed as allowing unauthorised parties to do so)	Disagree. This Standard is not the correct place to deal with licensing of ODP and unauthorised ODP business. The FMA sets out the legal framework governing ODP's
122.	BASA	4	Clarification sought on how this list ties in with the regulations around the Code of Conduct of registered OTC Derivative Providers and the requirement to obtain authoridation to be an OTC Derivative Provider from the FSCA/Registrar?	This paragraph must be read in conjunction with other laws and prescripts. Where an entity is required to be authorised in terms of a financial sector law, such authorisation is required
123.	Eskom	4	4(1) counterparty risk is mitigated by trading with either the exchange or a local bank with the highest national credit rating which limits the fund to the big 5 banks and by investing in relatively short date instruments/notes.	See Regulation 28 Principle 5. The Authority cannot place over reliance on credit ratings but can be considered by a board of pension fund as part of its broader risk management
124.	Futuregrowth	4	Add "a regulated entity" as a new type of counterparty. 4(g) a Regulated entity	Disagree, all the counterparties contemplated in paragraph 4 are by definition "regulated entities"
125.	Legae	4	"A fund may invest in listed derivative instruments and ~~only inves~~t in OTC derivative instruments where the counterparty is-" The general use of the phrase "derivative instruments" in the draft regulation may create confusion on the status of listed derivatives.	Agree with the comment. See amended wording to the Standard
126.	Legae	4(g)	Add "collective investment schemes" OTC derivatives can and should be allowed between regulated entities. The intervention of a "middle" party	Disagree with the comment, Authority is of the view that a CIS acting as a counterparty is not a regular occurrence. In order to accommodate other entities who may act as counterparties the

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			between such entities will increase concentration and systemic risk and increase cost. For the OTC derivative markets to have depth and liquidity regulated entities should be allowed to act as counterparties. It reduces systematic risk and supports efficient price formation.	Standard has been amended to include any other person declared by the Authority to be a counterparty. See comment above at item 124
127.	Legae	4(h)	Add "other pension fund organisations" OTC derivatives can and should be allowed between regulated entities. The intervention of a "middle" party between such entities will increase concentration and systemic risk and increase cost. For the OTC derivative markets to have depth and liquidity regulated entities should be allowed to act as counterparties. It reduces systematic risk and supports efficient price formation.	Disagree with the comment, we do not think that other pension fund organizations acting as counterparty is a regular occurrence
5. CALCULATING EXPOSURE				
128.	ASISA	5(1)	Please refer to the comment above on the definition of "net effective exposure". The definition should be amended to "net derivative exposure" to be consistent with its application in paragraph 2(2) and in this paragraph. It is understood that the intention of paragraph 5(1) is to ensure that the exposure to assets and asset categories are calculated by including the net derivative exposure (after long and short derivatives positions have been offset), not effective economic derivative exposure. This understanding aligns with the requirement in paragraph 2(2) of the Draft Conduct Standard that the net derivative exposure must be covered by appropriate assets in the fund. The reference to "effective economic derivative exposure"	See amended wording and response above See amended wording where we removed "economic" to read "net effective exposure"

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			in paragraph 5(1) should be replaced with a reference to “net derivative exposure” for the sake of consistency and to provide clarity for interpretation purposes. Proposed wording: A fund must, subject to subparagraph (2), ensure that the calculation of assets and categories of assets referred to in regulation 28 includes the ~~effective economic derivative exposure~~ net derivative exposure.	
129.	ASSA	5(1)	Clause 5(2) deals appropriately with conditions under which counter party exposure can be netted. However, clause 5(1) also covers effective economic derivative exposure to each regulation 28 category and does not refer to allowable netting of effective economic exposure in terms of paragraph 6. This could be interpreted as being contradictory to specifying that net effective exposure of derivatives should be considered in terms of regulation 28 category limits, per e.g. clauses 2(2), 6(1) and 6(3). Suggestion: Clause 5.1. should refer to “net effective exposure of derivatives” rather than “effective economic derivative exposure”. This change will make the clause consistent with the rest of the conduct standard, without impacting the conditions as specified in 5(2) re counter party netting limits.	Agree, see amendments made to the Standard
130.	Eskom	5(1)	This information is accounted for in our back-office records and we perform a reconciliation check daily	Noted. See response above (listed and unlisted derivatives)

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			with clearing agents and arrange for the settlement of margin calls if required(listed). For OTC investments, the counterparty bank uses an independent desk that can assist with objective valuations. Both listed and OTC derivatives are accounted for by the Investment Administration Department.	
131.	IRFA	5(1)	Clarity is required on how adjustment from effective economic exposure to the fund's overall fair market value needs to be made in Regulation 28 reporting	See response above at item 68
132.	Khumo Capital	5(1)	The current reporting template refers to fair value in schedules IA and IB with the effective economic exposure addressed in schedules G1 and G2. There are, however, also funds that report according to the draft notices on derivatives, i.e. they report effective economic exposure of the derivative instruments. Will you please confirm what the reporting framework will look like, i.e. will the effective economic exposure be reported in schedules IA and IB and the counterparty exposure / fair value in a separate schedule (please also see comments on 5(2) below)? The South African Reserve Bank ("SARB") reporting only refers to fair value of assets. Please advise how the regulation 28 reporting will be aligned and offshore limits applied if effective economic exposure is utilised for regulation 28 reporting purposes relative to fair market value for SARB purposes? Please also note, with reference to reporting effective economic exposure, the comment on the Cash category adjustment in the General Comments section below.	Comment noted. Reporting requirements will be issued to the industry. Also see comments below at item 133

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133.	PWC	5(1)	Effective economic exposure in Reg 28 - does this confirm that net fair value position will not be included in Reg 28 but the effective exposures? May cause differences between Reg 28 and Investment note in AFS. Per 5(2)(d) and 6 - under certain conditions it “must” be netted and others “may”. Should be consistent	Revised Regulatory Reporting Requirement to be issued for public comment along with the revised notes to the Annual Financial Statements will take this into account Agree with the comment and to accommodate this concern, we have amended the wording “must” in paragraph 6 of the Standard to “may”
134.	RisCura	5(1)	Please refer to our comment no 2 under general, as it relates to the requirement that under regulation 28 the foreign exposure limit is determined by the SARB prudential guidelines	Noted
135.	Sentinel	5(1)	This contradicts Regulation 28 as published in the Government Gazette, 4 March 2011. Section 3(e) of Regulation 28 states “Assets and categories of assets referred to in Table 1 must be calculated at fair value for reporting purposes” The current reporting template refers to fair value in schedules IA and IB with the effective economic exposure addressed in schedules G1 and G2. The South African Reserve Bank (“SARB”) reporting only refers to fair value of assets. How would Regulation 28 reporting will be aligned and offshore limits applied if effective economic exposure is utilised for Regulation 28 reporting purposes relative to fair market value for SARB purposes?	Fair market value is defined in the accounting framework and current regulatory reporting requirements that is currently under revision and will be issued for public comment by the Authority
136.	Sentinel	5(1)	Hedging currency risk may result in unintended circumvention of Regulation 28 limits. For example, if all offshore exposure is held in Private Equity and the fund wishes to hedge its currency risk, the implication of including the effective economic exposure in	See regulation 29, no look through principle is required on private equity and hedge funds as final assets

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			Regulation 28 is that it will reduce the offshore Private Equity exposure.	
137.	Futuregrowth	5(2)	"Counterparty" requires a definition and needs to include both an issuer and guarantor. This would align to Regulation 28 which references Issuer and/or Guarantor	Counterparty is defined in the Standard
138.	IRFA	5(2)	Subparagraph 5(2) does not provide clarity on how the counterparty exposure / fair value, that differs from the effective economic exposure, needs to be reported and how the 25% issuer / counterparty limit will apply	See response above at items 133 and 135. Fair value defined in accounting framework and regulatory reporting requirements
139.	JSE	5(2)	Paragraph 5(2) provides for the calculation of counterparty exposure, however the requirement to 'hold assets underlying a derivative position with a market value at least equal to the effective economic derivative exposure' effectively prevents a fund from buying protection for the default of a counterparty through a credit default swap, as the underlying reference asset may be a debt instrument (e.g. note) issued by a counterparty independently of the guarantor of the debt instrument.	The Authority's view is that it is important to consider differences in duration of debt instruments
140.	Khumo Capital	5(2)	As per the definition of counterparty exposure, it refers to the credit or settlement risk exposure, i.e. the fair market value of the derivative at any point in time, which is very different to the effective economic derivative exposure. Will there be a separate reporting section in the Regulation 28 template where the counterparty exposure, i.e. fair value, needs to be captured accordingly?	Comments noted and reporting requirements will be issued in due course
141..	Khumo Capital	5(2)	In Regulation 28, reference is only made to 25% maximum exposure to an issuer / counterparty as it	Comments noted

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			relates to cash and debt instruments (subparagraph 3(h) in Regulation 28). No reference is made to issuers of other instruments, e.g. equity and currency derivative instruments. Will this be addressed in this Conduct Standard or in Regulation 28?	
142.	RisCura	5(2)	Please refer to our comment 3 under general. We propose that the concept of a notional cash adjustment be addressed in this clause to ensure that on an aggregate basis the total Regulation 28 value of the fund’s assets to match the total fair market value of the fund’s assets	Disagree, synthetic cash is not allowed
143.	RisCura	5(2)	Please refer to our comment under the definition of “effective economic derivative exposure”. We propose that this clause addresses that when calculating the exposure to a reference asset, where that reference asset is itself a derivative or index, that there is a recursive requirement in the calculation until the exposure to physical assets is determined.	See response above and amendments to the Standard, for purposes of clarity the word “economic” has been removed from paragraph 5(2)
144.	Sentinel	5(2)	Would sub regulation 3(h) be adjusted to cater for derivative instruments?	Current revisions to regulation 28 are limited to infrastructure investments only
145.	Eskom	5(2)(a)	the fund invests in derivative instruments that trade on an exchange. Risk and Compliance monitor counterparty limit breaches.	Comment noted
146.	ASISA	5(2)(c)	Paragraph 5(2)(c) provides that listed derivatives cleared through a clearing house may be excluded from the calculation of counterparty exposure but that it must still be reported to the Authority. A fund reports exposure to listed derivatives against the limits per asset and asset category set in Regulation 28 and Table 1 (please refer to paragraphs 5(1) and 6(1). A	The Authority’s view is that notwithstanding the requirements of the Financial Markets Act, all exposures must be disclosed especially after the permitted netting requirements

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			reference to a reporting duty in the context of this proposed paragraph is confusing. The Statement supporting the Draft Conduct Standard does not contain any information in respect of this reporting requirement. Please confirm that the reporting referred to relates to the requirements of paragraphs 5(1) and 6(1). Technically it is unnecessary to set conditions for the rules of an exchange or clearing house in paragraph 5(2)(c) because the Financial Markets Act adequately provides the regulatory framework in this regard. It is suggested that the FSCA should consider the provisions of Chapter V in the Financial Markets Act and the removal of the conditions set in subparagraphs (i) to (iii) of paragraph 5(2)(c) in the Draft Conduct Standard.	
147.	ASISA	5(2)(c)	ASISA members suggest that a paragraph should be inserted after paragraph 5(2)(c) to provide for counterparty exposure where a derivative instrument is not traded on an exchange (OTC derivative) but is centrally cleared by a licensed central counterparty as contemplated in the Financial Markets Act. A central counterparty is defined as a clearing house that (a) interposes itself between counterparties to transactions in securities, becoming the buyer to every seller and the seller to every buyer and thereby ensuring the performance of open contracts; and (b) becomes a counterparty to trades with market participants through novation, an open offer system or through a legally binding agreement. Similar to the provision in paragraph 5(2)(c), it is suggested that the Conduct Standard should provide for OTC derivatives	See response above

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			that could be centrally cleared in future to be excluded from the calculation of counterparty exposure. Proposed wording: Where an OTC derivative is cleared through a licensed central counterparty as contemplated in the Financial Markets Act, a fund may exclude such counterparty exposure from the calculation.	The Authority's view is that all counterparty risks must be disclosed especially when netting
148.	BASA	5(2)(c)(ii)	Paragraph 5(2)(c)(ii) refers to IM being lodged for "overnight positions" – IM is not limited to overnight positions	Agree, see amendments to the Standard
149.	ASISA	5(2)(d)	It is understood that paragraph 5(2)(d) provides that counterparty exposure may be netted with exposure to the same counterparty if an ISDA is in place; in other words the net amount in terms of ISDA must be included in calculating counterparty exposure. Section 35B(1) of the Insolvency Act provides that all unperformed obligations arising out of one or more master agreements between the parties, or obligations arising from such agreement or agreements in respect of assets in which ownership has been transferred as collateral security, shall, upon the sequestration of the estate of a party to such master agreement, terminate automatically at the date of sequestration, the values of those obligations shall be calculated at market value as at that date, the values so calculated shall be netted and the net amount shall be payable. Section 35B(2) of the Insolvency Act defines master agreement as an agreement in accordance with standard terms published by among others the International Swaps	Insolvency provisions were considered in consultation with National Treasury

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			and Derivatives Association, which provides that, upon the sequestration of one of the parties - (i) all unperformed obligations of the parties in terms of the agreement - (aa) terminate or may be terminated; or (bb) become or may become due immediately; and (ii) the values of the unperformed obligations are determined or may be determined; and (iii) the values are netted or may be netted, so that only a net amount (whether in the currency of the Republic or any other currency) is payable to or by a party, and which may further provide that the values of assets which have been transferred as collateral security for obligations under that agreement shall be included in the calculation of the net amount payable upon sequestration. The references to "relevant transactions" and "underlying transactions" in paragraph 5(2)(d) is inconsistent with the references to "unperformed obligations" in section 35B of the Insolvency Act and is therefore confusing. A reference to "netting as contemplated in section 35B of the Insolvency Act" is sufficient for the purpose of subparagraph (i); the elaboration causes confusion. The references to "mark-to-market" and "underlying transactions" in subparagraph (ii) should be replaced with "market values" and "unperformed obligations" for the sake of consistency and to avoid confusion. "Counterparty	

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			exposure" is a defined term and should replace "exposure to a counterparty". Proposed wording: In calculating the counterparty exposure- (d) a fund's counterparty exposure ~~to a counterparty~~ may be netted ~~off~~ with exposure to the same counterparty, on condition that an Agreement is in place, which Agreement- (i) gives legal effect to netting as contemplated in section 35B of the Insolvency Act, 1936 (Act No. 24 of 1936) ~~to create a single legal obligation, covering the relevant transactions included in the calculation of the counterparty exposure~~; and (ii) provides that, where such counterparty defaults, the fund has an obligation to pay only the net sum of the positive and negative ~~mark-to-~~market values of the ~~underlying transactions~~ unperformed obligations; and	Agree with proposed wording. See amendments to the Standard
151.	ASISA	5(2)(e)	"Counterparty exposure" is a defined term and should replace "exposure to a counterparty". It is also suggested that the FSCA consider moving paragraph	Agree, see re-ordering of paragraphs 5(2)(e) that has been inserted after paragraph 5(2)(a)

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			5(2)(e) to follow on paragraph 5(2)(a) as these paragraphs have general application. <u>Proposed wording:</u> In calculating the counterparty exposure- (e) <u>counterparty</u> exposure ~~to a counterparty~~ in respect of collateral must be included.	
152.	PWC	5(2)(e)	States that exposure to a counterparty in respect of collateral must be included in calculating counterparty exposure, but in 5(2)(b) it states that a fund may reduce the counterparty exposure by the value of collateral provided.	Noted
153.	BASA	General	➢ Guidance is requested on what can and can't be used as liquidity assets as a cover asset. ➢ Guidance is also requested on maturity and whether there are any liquidity constraints on the underlying cover asset. We recommend that this should align with existing prudential regulation.	High quality liquid assets as defined by SARB or FMA or align with CSCA Timelines to be set out in Standard
154.	BASA	5	Is it intended that this section refers to OTC derivatives only?	All derivatives direct and indirect as well as local and foreign investments with equivalence
156.	BASA		Clarification is sought as to whether a pledge and cession would be nettable under the insolvency act	Collateral cannot be netted
6. NETTING				
157.	ASISA	6(1)	Please refer to the comment above on the definition of "net effective exposure". The definition should be amended to "net derivative exposure" to be consistent with its application in paragraphs 2(2), 5(1) and in this paragraph.	See amended wording in the Standard. However, the Authority disagree with deletion of the wording "underlying the derivative exposure" and retained the above wording for clarity in the context of the Standard.

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			It is understood that paragraph 6(1) is intended to provide for specific cover requirements to support the general requirement in paragraph 2(2) of the Draft Conduct Standard that the net derivative exposure (after long and short derivative positions have been offset) must be covered by appropriate assets in the fund. In other words, the exposure to the reference asset of the derivative instrument must be identical or similar to the asset/s held by the fund for it to qualify as appropriate assets for the purposes of the required cover. The wording of paragraph 6(1) may cause confusion in that it refers to netting of asset exposure with the effective economic derivative exposure (before long and short derivative positions have been offset). For the sake of clarity, it is suggested that paragraph 6(1) should be rephrased to clarify that the asset exposure must be combined with the net derivative exposure where the reference asset of the derivative is identical or similar to the assets held by the fund. In subparagraphs (a), (b) and (c)(iii), the references to “underlying the derivative position” should be deleted for the sake of clarity and consistency. If the definition of “reference asset” is considered in this context, it captures assets “underlying the derivative position”. Also, the references to “fund assets” should be replaced with “assets, or categories of assets, held by the fund” for the sake of consistency. In subparagraph (c)(ii), the reference to “portfolio”	The proposed wording in (iii) does not allow for netting of derivative positions only assets and portfolio of assets held by the fund

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			must be replaced with a reference to the “assets in the portfolio” as a benchmark may only refer to a portion of a portfolio’s assets (e.g. equities) and not necessarily all the assets Proposed wording: In calculating the fund's compliance with the limits set out in regulation 28, the effective economic exposure of the assets, and categories of assets, held by the fund must be combined with the net derivative exposure ~~netted with the effective economic derivative exposure~~ where the reference asset of the derivative instrument is identical or similar to the assets, or categories of assets, held by the fund. Similar in this context means that the reference asset - (a) is not an index and such reference asset is highly correlated with the assets held by the fund ~~assets underlying the derivative position~~ thereby leaving no material residual risk; (b) is an index, calculated and published by an exchange and such index is highly correlated with the assets, or categories of assets, held by the fund ~~to the fund assets underlying the derivative position~~ thereby leaving no material residual risk; or (c) is an index that is not calculated or published by an exchange, and such index- (i) is sufficiently diversified so that price movements of one of the assets	

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			included in the index do not unduly affect the performance of the index as a whole; (ii) represents an adequate benchmark for the market or assets in the portfolio to which it refers, including regular measurement, rebalancing and liquidity appropriate to replicating the index; and (iii) is highly correlated with the assets, or categories of assets, held by the fund ~~to the fund assets underlying the derivative position~~ thereby leaving no material residual risk.	
158.	ASSA	6(1)	To remove ambiguity regarding what derivative exposure can be netted and to be consistent with clause 6(3) and the definition of "net effective exposure", the third line of the paragraph should refer to "net effective exposure of derivatives" and not "effective economic derivative exposure". Also, to remove ambiguity in the case of e.g. currency hedging, the clause should not state "…is identical or similar to the assets held by the fund." but rather "…is identical or similar to the asset **exposure** held by the fund."	Wording amended as per response above at item 157 See amendments made to the Standard
159.	BASA	6(1)	"The reference asset must be: (a) Is not an index and is highly correlated with the underlying the derivative position thereby leaving no residual risk." To say that it's leaving no residual risk is difficult to achieve? Pension funds may want to net something off.	See added wording to allow management of residual risk but it needs to be disclosed in annual, audited financials as prescribed

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			(For example, the underlying may be in equities, but the most effective hedge you can do is in the index space. It would not be effective to restrict that, but it is possible to slip out and be 10% over a given period.)	
160.	BASA	6	Is it intended that this section refers to OTC derivatives only? Does the reference to JIBAR or foreign equivalents include a reference to alternative reference rates in the context of IBOR cessation?	See amended wording
161.	Eskom	6(1)	6(4) the fund has a conservative derivatives policy.	Comment noted
162.	JSE	6(1)	We have understood the term ‘net’ or ‘netting’ used in paragraph 6 to mean ‘offset’ and ‘offsetting’ and not netting in a legal context (e.g. in the case of an insolvency or default of a counterparty). Although sub-paragraphs 6(1)(a), (b) and (c) provides context for the term ‘similar” used in relation to reference assets’, this does not provide clarity in respect of cross-asset offsetting or cross-instrument offsetting where the derivative and reference asset or instrument may be highly correlated. Consequently, further clarity or guidance is required – (i) in respect the permitted approach to cross-asset or cross-instrument offsetting; and (ii) in respect of the meaning of the terms ‘highly correlated’ and ‘material residual risk’.	See response above at item 157 for amended wording and re-ordering of the relevant paragraphs
163.	Sentinel	6(1)	Again, Section 3(e) of Regulation 28 states “Assets and categories of assets referred to in Table 1 must be calculated at fair value for reporting purposes”. This	All net positions must be reflected in annual financial statements of the fund (see note G1 & G2)

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			is different to effective economic exposure on derivatives.	
164.	Sentinel	6(1)	This clause does not cater for currency hedging.	See amended wording and item 157 above
165.	ASSA	6(1)(b)	Wording in the current format is highly problematic as it may be interpreted as precluding retirement funds from any feasible hedging through using an equity index derivative in the SA market. This in turn is highly problematic, as the three main listed equity indices (Top40, Swix40 and Capped Swix40) are realistically the only liquid and efficiently priced hedging alternatives for diversified equity exposure in the SA market. These indices are widely used as the best available proxy to hedge against general equity market exposure. However, it is debatable if these indices can be said to leave “no material risk” versus any general equity fund or segregated equity mandate exposure being managed in SA. For example, almost no actively managed portfolio (ie non index tracking portfolio) would ever hold all share constituents in the Top40 index. Note also that standardised published indices are clearly not open to their constituents being changed or manipulated by a fund or derivative provider in order to increase risk to the fund. Given the above it would seem reasonable that the matching requirement for listed indices should be less onerous when compared to non-index or non-listed instruments per 6(1)(a) and 6(1)(c). Note also that any residual risk that remains in terms of listed index	The Standard does provide for tracker & index based derivative portfolios for LDI investments

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			hedging per this clause does still have to be managed in terms of 6(4). Suggestion: Change wording to "is an index, calculated and published by an exchange and such index is highly correlated to the fund assets underlying the derivative position thereby leaving limited residual risk; or"	Disagree, Authority's view is that residual risk must be disclosed and managed
166.	Eskom	6(1)(b)	6(1) …Similar in this context means that the reference asset – (b) is an index, calculated and published by an exchange and such index is highly correlated to the fund assets ~~(underlying the derivative position)~~ thereby leaving no material residual risk; The indicated words to be deleted do not make sense in this clause. The reference asset is an index. The assets underlying the derivative position is the index. Is it not the index that needs to correlate to the fund assets. The index, by way of to its nature and constituents, would need to be highly correlated to the assets of the fund.	This is to ensure that the required full look through principles is also applied to "wrappers" of derivatives. Also see comments above at item 165 and amendments to the Standard
167.	Legae	6(1)(b)	"is an index, calculated and published by an exchange and such index is ~~highly correlated~~ an appropriate proxy to the fund assets underlying the derivative position ~~thereby leaving no material residual risk~~; or" Listed index futures are used on a regular basis to reduce retirement fund's overall exposure to financial markets. Insisting that is should be "highly correlated" and "no material exposure" is highly punitive.	Agree with the deletions of "highly correlated". Proxy is well understood in terms of good governance. For the balance of the proposal see comments above and responses at item 157

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			The current draft regulation proposes the same limitations on non-index (6 (1) (a)) and listed index 6 (1) (b). Listed indices have the benefit of universal acceptance and independent calculation.	
168.	Eskom	6(1)(c)(iii)	(c)(iii) is highly correlated to the fund assets ~~(underlying the derivative position)~~ thereby leaving no material residual risk; Same comment as above – delete the words in brackets	See comments above and item 157
169.	IRFA	6(1)(c)	The underlying of the derivative instruments would have to be reported more strictly by asset managers and require additional resources.	Funds will have 12 months transitional period to revise Investment Policy Statements, mandates, and contracts to align to the Standard
170.	ASISA	6(2)(a)	In its submission on the November 2013 Draft Conditions, ASISA members commented that the paragraph should be clarified to provide for when the duration exposure of debt instruments is managed. This may have been the intention but the Statement supporting the Draft Conduct Standard does not contain information that could assist with confirming this interpretation and the absence of an FSCA response to comments on the November 2013 Draft Conditions amplifies the uncertainty. The wording of the paragraph is confusing, e.g. a debt instrument is not netted with a derivative instrument, the duration of the debt instrument is hedged with for example a swap instrument. It remains unclear why the FSCA wishes to limit the types of reference assets in the case of interest rate derivatives. Please refer to the comment above on the	

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			suggested deletion of the definition of swap rate. When specific types of reference assets are overly prescribed, investment options for funds may be severely restricted without any apparent associated benefit. It could be that the FSCA considered that the reference assets should be subject to some form of regulation, but it is submitted that the overarching requirements set in Regulation 28 (for example responsible investment; assets to be appropriate for liabilities, due diligence before making investments, risk analysis and understanding changing risk profiles), the limits applicable to entities/issuers and asset categories set in Table 1 to Regulation 28 and the risk management requirements envisaged by the Draft Conduct Standard (for example restricted use, consistency with investment policy, cover, valuation, risk management policy, restricted counterparties and reporting) adequately controls exposure to derivatives. Additional very specific prescription of reference assets will have a probably unintended consequence of precluding a fund, when applying look-though as required by Regulation 28(4) from investing in CIS portfolios and insurance policies which are not subject to similar regulatory limits. In response to the November 2013 Draft Conditions, it was suggested that the paragraph should also make provision for the foreign equivalents of the identified reference assets to provide for foreign instruments. It is again submitted that subparagraph (i) should be rephrased to allow for the foreign equivalents of the	The Authority's is of the view that principles based frameworks is not only sufficient. In some instances there is a need to include some rules The Authority's view is to retain the wording "reference asset" concept versus "appropriate assets" in line with the concept of "covered positions" and netting provisions

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			reference assets, not only certain types of reference assets. ASISA members, in its submission on the June 2012 Draft Conditions, commented that the required disclosure of consequential or residual spread exposure will cause confusion as there is no indication of how the exposure should be disclosed. In its response document, the regulator indicated agreement and amended the wording in the November 2013 Draft Conditions to provide for the exposure to be managed and monitored. The wording in this Draft Conduct Standard reverts to the wording of the June 2012 Draft Conditions. This reversion is not understood. It is again submitted that the required disclosure is confusing. How will a fund be expected to disclose residual spread exposure? It is more appropriate to provide that residual exposures are monitored and managed. Paragraph 6(2)(a) should be rephrased to clarify that it applies where a fund uses derivative instruments for the purpose of managing the duration of the debt instruments held by the fund. The proposed wording is consistent with the proposed wording of paragraph 6(1) above. Further amendments are proposed for the sake of clarity and to align with the terminology used in Regulation 28. <u>Proposed wording:</u>	See response above at items 133 and 135. Disclosures are contained in the prescribed annual financial statements and the accounting guide is contained in the Regulatory Reporting Requirements Netting provisions must be clear (not vague) in order to safeguard the assets of the fund

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			Despite subparagraph (1), where a fund uses derivative instruments for the purpose of managing the duration of the debt instruments held by the fund and in calculating the fund's compliance with the limits set out in regulation 28 - (a) debt instruments held by the fund may be combined with the net derivative exposure where the ~~netted with a derivative instrument whose~~ reference asset of the derivative instrument is- (i) a ~~bond~~ debt instrument issued by the government of the Republic ~~or a foreign asset~~, JIBAR ~~or a foreign equivalent of JIBAR~~, the repurchase rate, an inflation rate or swap rate, or a foreign equivalent of these reference assets, provided that any consequential or residual spread exposure as a result of the netting is ~~disclosed~~ monitored and managed; or (ii) a debt instrument with the same issuer but a different term, provided that any residual exposure as a result of the difference in term and spread is ~~disclosed~~ monitored and managed;	See amendment made to the Standard See amendment made to the Standard Agree with the additions except that the wording "disclosed" is retained in addition to "monitored and managed"
171.	IRFA	6(2)(a)	Compliance would require significant systems development to ensure adherence and sufficient time should be granted.	See transitional period amended to 12 months
172.	Legae	6(2)(a)(i)	~~"a bond issued by the government or a foreign asset, JIBAR or foreign equivalent of JIBAR, the repurchase rate, an inflation rate or swap rates~~ deriving its value from the same rate as the debt instrument, provided	See response above at item 170 and ASISA's proposed wording

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			that any consequential or residual spread exposure as a result of the netting is disclosed; or" Subparagraph 6(2)(a) specifies that a debt instrument may be netted against a derivative instrument Subparagraph 6(2)(a)(i) then requires that the reference asset of the derivative (used in the netting) could be any of a defined set of instruments. 1. Subparagraph 6(2)(a)(i) referrers to a reference asset that is - A bond issued by the government - A foreign asset (is supposed to mean foreign government) - Set of rates (JIBAR / repurchase rate / inflation rate / SWAP rate) However there are many more (e.g. South African Benchmark Overnight Rate (SABOR), international LIBOR etc.) 2. The issuer of the reference instrument (e.g. government) determines credit risk while the underlying / reference rate of the debt instrument determines its effective exposure. Instead netting should focus on the fact that the - the debt instrument held by the fund AND - reference asset of the derivative should be linked to the same <u>rate.</u>	
173.	Eskom	6(2)(a)(i)	Debt instruments held by the fund may be netted with a derivative instrument whose reference asset is-	Disclosure of derivatives is contained in the audited financials of funds as well as local and "foreign assets" as defined in Regulation 28

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			(i) a bond issued by the government … [is this the RSA government] ……or a foreign asset [what is meant by a foreign asset? Can the foreign asset be an equity, property? Please specify what kind of foreign asset. Is this meant to read "foreign debt instrument", assuming that this "foreign debt instrument" would also include debt issued by a foreign government? Would a domestic debt instrument be able to netted with a foreign derivative instrument and vice versa?	
174.	Futuregrowth	6(2)(a)(i)	Add to the end of the clause "provided that the debt instrument or derivative instrument are of similar term"	See above comments at item 170
175.	Legae	6(2)(a)(i)	"~~a debt instrument with the same issuer but a different term, provided that any residual exposure as a result of the difference in term and spread is disclosed;~~" This subparagraph does not tie-up with subparagraph 6 (2) (c); Also It is assumed that paragraph 6(2) concerns it with the effective market exposure. The netting of interest rate assets and derivatives is about market risk and not credit risk. Netting of market exposure should not be determined by the issuer. Credit risk are calculated in accordance with the other provisions of draft notice. The issuer should not affect the netting (only the term / duration).	Inserted reference to netting provisions on term and duration to clarify wording
176.	ASISA	6(2)(b)	No fund should be compelled to manage the duration of debt instruments held the fund. Duration management may not be appropriate in the context of a specific fund. Regulation 28 assigns the	Agree, see amendments made to the Standard

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			responsibility of managing the investments of a fund in a responsible manner and the obligation that the assets of the fund are appropriate for its liabilities etc., to a fund and its board. The Statement supporting the Draft Conduct Standard does not contain any information that could assist with understanding the regulatory objective of overriding the fund and its board and requiring that all pension funds must manage the duration of its debt instruments. It is therefore proposed that paragraph 6(2)(b) should be deleted.	
177.	BASA	6(2)(b)	This may be difficult to do in practice. For example, with a debt instrument where they are netting to JIBAR. There may be a reference to JIBAR on both sides of the trade but the reference to JIBAR on the one side may be much longer in duration than on the other side.	See comments above at item 176
178.	Legae	6(2)(b)	"~~duration exposure must be managed in the case of debt instruments;~~" An inexplicit statement that does not affect the netting calculation and it is unclear what type of management of duration is required.	Disagree, the wording is retained to address differences between equity reference assets and debt reference assets when using derivatives for example hedging
179.	ASISA	6(2)(c)	Paragraph 6(2)(c) contradicts paragraph 6(2)(a)(ii) which allows for a debt instrument with the same issuer but a different term to be a reference asset of a derivative instrument. In other words a debt instrument held by the fund may be combined with the net derivative exposure to the same issuer despite differing terms/durations of the debt instruments. If netting is only permitted for debt instruments with the	Agree, see amendments made to the Standard

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			same outstanding duration or term, a fund will not be able to hedge a 10-year government bond with a 5-year interest rate swap. This could not have been the intention. It is therefore suggested that paragraph 6(2)(c) should be deleted.	
180.	Legae	6(2)(c)	"netting is only permitted for debt instruments with similar ~~the same~~ outstanding duration ~~or term~~." Outstanding duration is calculated in days. It is too punitive to demand "the same" outstanding duration. The "term" of a debt instrument refers to "legal expiry" and has little effect on the economical exposure of the debt instrument. It may lead to a large mismatch in exposure if only the term of the debt instrument and the derivative is the same.	See response above at item 176
182.	Futuregrowth	6(2)(c)	We would suggest removing this clause in its entirety because in our view it is in conflict with 2 (a) (ii)	Agree, seem comments above at item 176
183.	ASISA	6(3)	The Statement supporting the Draft Conduct Standard does not contain any information that could assist with understanding the regulatory objective of paragraph 6(3). It is presumed that the intention is to prohibit a fund from applying more than one derivative exposure to one asset held by the fund. In its submission on a similar provision in the November 2013 Draft Conditions, ASISA members suggested that the paragraph should be deleted as more than one derivative cannot be applied to the same asset when net derivative exposure (offsetting of long and short derivative positions) is calculated. Please also refer to	See amended definition of net derivative exposure

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			comment above on the definition of net effective exposure which should be net derivative exposure. The view is held that the cover requirements (appropriate assets to be held by the fund) is an adequate mechanism to control the application of multiple derivative exposures to a single asset. A fund should not be prevented from for example hedging market risk and currency risk associated with the same asset or category of assets by for example using currency derivatives, as long as the derivative exposures are covered by appropriate assets. A fund may wish to hedge its foreign equity market exposure and also the currency exposure of those foreign equities. It is not understood why the regulator would limit hedging strategies for more than one risk associated with a specific asset or categories of assets held by a fund. ASISA members therefore again suggest that paragraph 6(3) should be deleted.	
184.	BASA	6(3)	The permission to allow the economic exposure of an asset to only be offset once should include clarity that this will allow for portfolio hedging using a single trade and is not limited to one-to-one transaction mapping.	Agree, see amended Standard
185.	ASISA	6(4)	Paragraph 3(1) of the Draft Conduct Standard requires a fund to adopt and implement a risk management policy to identify, measure and take steps to manage and mitigate, as appropriate, the exposure to and risks of derivatives, and the contribution of these to the overall risk profile of the fund's investment portfolio. Paragraph 3(2) requires a board to ensure that it is aware of, and continuously monitors, the risks to the fund using derivative	Agree, see amended Standard

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			instruments, and that such risks are appropriate in terms of the fund’s solvency and liquidity position. Paragraph 6(2)(a) requires residual exposures from netting in managing duration to be managed and monitored. If paragraphs 3(1), 3(2) and 6(2)(a) are considered and the overarching risk management principles in Regulation 28(2) are borne in mind, paragraph 6(4) seems repetitive and superfluous. The Statement supporting the Draft Conduct Standard does not contain information to indicate a purpose for this paragraph to distinguish it from other similar paragraphs. ASISA members suggest that paragraph 6(4) should be deleted.	
186.	Legae	6(4)	“Any residual risk or residual exposure must be monitored by the fund and where appropriate the fund must take steps to manage and mitigate these risks and exposures.” Residual risk and exposures are by products of the portfolio management process. In many instance is it more cost effective not to attempt to manage these residual risks. It is only when these residual risks and exposures may have a substantial impact on the risk or return that it should be mitigated and managed. It is however appropriate to monitor these residual risks.	See comments above at item 185
187.	BASA	6(1)(a)	“High correlation” can be interpreted very broadly; some guidance as to how this will be measure will be useful	Previously the FSB defined correlation as a percentage. However, based on initial comments received it was changed to “high” correlation meaning 90% or more

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188.	BASA	6(1)(c)(i)	We recommend that "Sufficient diversification" be further clarified; especially in the context of the South African index composition (e.g. Naspers concentration in the index; or for example if its fine the 10% of the index makes up the primary amount of value)	Disagree, the concept is well understood already in the context of regulation 28, the Statement of Need and the purpose of this Standard
189.	IRFA	6(4)	Insurers will have to manage this internally. We propose that the Conduct Standard requires a written policy and procedure.	See comments above at item 199
7. COLLATERAL				
190.	Legae	7	It is not clear if the requirements of subparagraphs 7 (2) to 7(7) is applicable to collateral **received** and/or to collateral **placed.**	Comment noted. Each fund must enter into its own collateral agreement in line with the provisions of paragraph 7. Such agreement must not conflict with the provisions of paragraph 7. The Authority will not prescribe the detail of such agreement.
191.	BASA	7(1)	Paragraph 7(1) requires a "bilateral collateral agreement" – it may well be that bilateral application is not appropriate, and the Fund's exposure to the counterparty or vice versa does not have to be	See amended wording including "bilateral" collateral agreement collateralized
192.	Eskom	7(1)	7(1) That agreement for listed derivatives is signed with the JSE as part of the General client – exchange agreement. For ELNs, (which may qualify as OTC derivatives), there is no collateral because the investment is fully funded and part of the issuing bank's DMTN programme, ELNs may not qualify as derivatives. The fund will ensure that bilateral collateral agreements will be put in place if required.	Comments noted, this provision provides not only for OTCs
193.	Legae	7(1)	"~~Where a collateral arrangement is entered into by a fund, the fund must ensure that the Agreement Includes a bilateral collateral agreement~~."	See comments below

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			Subparagraph 7(1) requires that all collateral arrangements should always be **bilateral.** It is proposed that this subparagraph is deleted. This requirement will severely impact on the effective working of the OTC derivative market. The placing of collateral is primarily a counterparty/credit risk management financial transaction. For example the fund may require collateral from a counterparty while the fund may not need (or choose not) to place collateral. The pricing of OTC derivatives may substantially change if bilateral collateral is required. The draft regulation already have a comprehensive framework for counterparty risk including that of collateral arrangements. The private commercial arrangements regarding credit exposure and the management of it between the fund and the counterparty should not be dictated to be always bilateral. The fund may also not have the operational ability to receive collateral. The OTC provider regulation already has a comprehensive framework of when and how collateral (bilateral or not) should be managed.	
194.	ASISA	7(2)	Joint Standard 2 Of 2020 on Margin Requirements for Non-Centrally Cleared OTC Derivative Transactions, in paragraph 7(2)(a), stipulates that the following assets and instruments will constitute eligible collateral for purposes of relevant calculations of initial and variation margin:	Agree, see amendments made to the Standard

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			(a) cash; (b) gold; be liquid, transparent and identifiable (c) such high-quality government and central bank debt securities as may be specified in writing by the Authorities; (d) such high-quality corporate bonds as may be specified in writing by the Authorities: (e) such equities included in major indices as may be specified in writing by the Authorities: and (f) such other assets or instruments as may be specified in writing by the Authorities. To date, the Authorities have not specified the assets or instruments referred to in subparagraphs (c) to (f) of the relevant paragraph in Joint Standard 2. This effectively means that a fund will be restricted to cash and gold as eligible collateral. The Statement supporting the Conduct Standard does not contain information on the rationale for prescribing specific eligible collateral for a pension fund. It is presumed that the intention was to provide a regulatory source (Joint Standard 2) for eligible collateral. It however seems overly prescriptive in the context of a pension fund. It is near impossible to consider whether the prescribed collateral is appropriate and to formulate a response thereto without knowledge of the assets or instruments that the Authorities are to specify in writing. The November 2013 Draft Conditions provided that collateral must be liquid, transparent and identifiable and valued daily. This principle approach is more suited in the context of collateral arrangements	

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			entered into by pension funds, also considering that a fund must ensure that the ISDA Agreement includes a bilateral collateral agreement (credit support annexure). It is therefore proposed that paragraph 7(2) should be rephrased to remove the disproportionate prescription of eligible collateral in the context of pension funds. The reference to collateral asset should also be applied to paragraphs 7(4) and 7(5) for consistency. Proposed wording: The assets or instruments eligible for collateral ("collateral asset") in terms of a collateral arrangement must- (a) be liquid, transparent and identifiable ~~consist of assets or instruments prescribed as eligible collateral in FSRA Joint Standard 1 of 2020 - Margin Requirements for non-centrally cleared OTC Derivative Transactions~~; (b) be held by the fund, or an approved nominee or an independent custodian in a segregated depository account on behalf of the fund; and (c) be capable of being valued daily.	Agree
195.	Legae	7(2)(b)	"be held by ~~the fund, or~~ an approved nominee or an independent custodian in a segregated depository account ~~on behalf of the fund~~; and". It is unclear if this requirement relates to collateral received or placed by a fund.	See comments above at item 194

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196.	Legae	7(2)(b)	"be held by the fund, or an approved nominee or an ~~independent~~ custodian in a segregated depository account on behalf of the fund; and" A custodian is per definition and by legislation a standalone legal entity that fulfils a fiduciary role. Using the word "independent" here may indicate that it is requirement that the custodian is supposed to have no links with the fund or the counterparty. (e.g. not a current custodian or member of the same group of companies)	Comment noted
197.	Futuregrowth	7(3)	Is this clause not in conflict with the Insurance Act, as you cannot pledge assets under the Insurance Act?	Disagree with this comment It is true that the assets of a fund cannot be pledged, ceded, or hypothecated. However, this requirement does not deal with pledging of the fund's assets. The party in a derivative transaction must fulfill the collateral requirements in the Standard.
198.	Legae	7(3)(a)	"~~the fund and the counterparty agreed that in the event of a default, the obligation of the counterparty to return the collateral will terminate;~~" It is not true that an "outright transfer" of collateral means that the counterparty does not need to return collateral in case of default.	Comments noted
199.	Legae	7(3)(b)	"~~the value of the collateral assets transferred by the counterparty to the fund will be established; and~~" It is not required to establish the value of the collateral assets at point of transfer as a unique requirement for "outright transfer" The valuation of collateral is already covered under subparagraph 7(2)(c).	Comments noted

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200.	Legae	7(3)(c)	This subparagraph 7(3)(c) refers to "values (plural) referred to in item (b)". It is assumed that this refers to values referred to in subparagraph 7 (3) (b). However subparagraph 7(3) (b) only refer to **<u>one</u>** "value" namely "value of the collateral". It is assumed this subparagraph refers to collateral and outstanding payments netted. This is not a unique requirement for collateral transferred on an outright basis. It is unclear why this is provision for collateral to be done on an outright basis.	Comments noted
201.	ASISA	7(4)	Please refer to the comment above on paragraph 7(2) and the proposal that eligible collateral should not be overly prescribed for pension funds. The reference in paragraph 7(4) to "cash, money market instrument, debt instrument or equity" as collateral assets is inconsistent with the wording of paragraph 7(2) and should be replaced with a reference to the collateral asset. The spelling error should be corrected. <u>Proposed wording:</u> Collateral referred to in this paragraph may be ~~affected~~ <u>effected</u> through- (a) a pledge or cession in security to the fund of the <u>collateral asset</u> ~~cash, money market instrument, debt instrument or equity ("collateral asset")~~, or (b) an outright transfer of the collateral asset to the fund.	See proposed wording above at item 194 See amendments made to the Standard
202.	BASA	7(4)(a)	Envisages collateral movements to the fund only. However in 7(1) reference is made to a Bilateral	See amended wording including "bilateral" collateral agreement

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			Collateral agreement envisaging circumstances where collateral may be placed with the counterparty. Should this therefore not be amended to include collateral placed by the fund can be done by a security cession and pledge. Clause 7(6) refers to out right transfer of collateral to the Counterparty so to and from fund on an outright basis is covered	
203.	Legae	7(4)(a)	"a pledge or cession in security ~~to the fund~~ of the cash, money market instrument, debt instrument or equity ("collateral asset"), or" Collateral can be placed and received by the fund.	Comments noted, changes already made in line with comments at item 201 above
204.	Legae	7(4)(b)	"the outright transfer of the collateral asset ~~to the fund~~." Collateral can be placed and received by the fund.	See comments above at item 201 above
205..	Legae	7(5)	"Where collateral is received by the fund and ~~If~~ the outright transfer method is elected –" Subparagraph 5(a) and 5(b) both deal with the fund receiving collateral and not with the fund placing collateral.	Agree, see amendments made to the Standard
206.	Futuregrowth	7(5)	In our view this clause is possibly incorrect, if you do an "outright transfer" it can only be in the fund's name if the fund receives the collateral, if the fund pays the collateral the collateral will be in the name of the counterparty	The issue of ownership of collateral is actually legally technically quite complicated. Due to their nature, securities are transferred by way of a cession. A cession is a bilateral act by which a personal right is transferred from a cedent to a cessionary. There are two types of securities cession namely: • an out-and-out cession in terms of which the rights are transferred completely by the cedent to the cessionary; and

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				• a cession in securitatem debiti in terms of which the cedent retains a reversionary interest in the ceded right. True ownership in securities is transferred by an out-and-out cession. In the uncertificated securities environment, such a transfer is effected by the parties agreeing to cede the securities fully on an out-and-out basis which is accompanied by the transfer of registered ownership in the uncertificated securities through the debiting and crediting of the respective securities accounts in accordance with the Companies Act and the FMA. The current state of the South African law is that a cession in securitatem debiti of an incorporeal right is akin to a pledge of a corporeal thing and ownership is not transferred.
207.	Futuregrowth	7(5)	We need more clarity of this level of exposure, we suggest an example (this will be during extreme market movements or a credit event on a specific counterparty-this would not be standard?)	Comments noted, pension funds and boards must follow a principles-based approach. Also see comments above at item 205
208.	BASA	7. Collateral	Does this section refer to OTC derivatives only?	See amendment made to the Standard as well as comments above at item 194
209.	Legae	7(7)	Where collateral is held by an independent custodian as contemplated in subparagraph (2)(b) such collateral does not form part of the assets of that custodian and will not be regarded as counterparty exposure to that custodian. To clarify that collateral posted in terms of subparagraph 2(b) is still part of the calculation of	Agree, see amendments made to the Standard

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			exposure (and offsetting of collateral) to the derivative counterparty but not to the custodian.	
210.	BASA	General	This section on collateral seems to reference the "initial margin" scenario when it refers to collateral being held in the name of the fund or segregated. We recommend a separate requirements for initial margin and variation margin as the operational requirements are quite different	Comments noted
211.	BASA		Is it intended that pension funds will be exempt or will they be required to margin deals as well? Pension funds are not defined as "counterparties" under the Margin Regulations and this section must be clarified not to be mandating the exchange of margin on OTC deals.	See comments above at item 194
8. RECEIVING OF INFORMATION				
212.	ASISA	8(1)	The reference to paragraph 7 of the FMA Conduct Standard for Authorised OTC derivative providers in respect of the agreement is superfluous; the requirements for an agreement with the OTC derivative provider will apply regardless of the reference. A similar requirement is applicable to FSPs in the FAIS Code of Conduct, yet that is not referred to in paragraph 8(1). It is therefore suggested that the reference to paragraph 7 of the FMA Conduct Standard should be deleted. Proposed wording: A fund must ensure that its investment mandates with financial services providers or ~~the~~ an agreement with ~~the~~ an OTC derivative provider ~~as referred to in paragraph 7 of FMA Conduct Standard 2 of 2018 -~~	Agree, see amendments to the Standard

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			~~Conduct Standard for Authorised OTC derivative provider~~ require that the fund receives appropriate and timely information to enable proper management and monitoring of derivative instrument positions and collateral, and compliance with the relevant limits set out in Regulation 28.	
213.	Eskom	8(1)	Investment Mandate agreements will be updated to incorporate the reporting requirements.	Comments noted. In order to provide for adequate period to update internal procedures, the transitional period has been amended to 12 months
214.	ASISA	8(2)	It is suggested that the reference to subparagraph (1) should be deleted as financial services provider and OTC derivative provider are defined terms. Proposed wording: A fund must receive the following information from a financial services provider or OTC derivative provider ~~as referred to in subparagraph (1)~~ at least quarterly:	Agree, see amendments to the Standard
215.	Legae	8(2)(a) and (b)	An OTC derivative provider does not have oversight of a funds non-derivative assets. It would not be able to confirm, for example: - a full list of the fund's assets ... (subparagraph 8(2) (a)) - the derivative instruments are used for efficient portfolio management (subparagraph 8(2)(b)) An OTC derivative provider would be able to provide the details as specified in subparagraphs 8(2) (c) and (d).	Agree, see amendments made to the Standard

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			Proposal A: "8 (2) A fund must receive the following information ~~from a financial services provider or OTC derivative provider as referred to in subparagraph (1)~~ at least quarterly:" **Proposal B:** Split sub paragraph 8 (2)(c) and (d) to new sub paragraph 8(3) (a) and (b) "8 (2) A fund must receive the following information from a financial services provider ~~or OTC derivative provider as referred to in subparagraph (1)~~ at least quarterly: (a) current subparagraph 8 (2)(a) (b) current subparagraph 8 (2)(b)" "8 (3) A fund must receive the following information from a financial services provider or OTC derivative provider as referred to in subparagraph (1) at least quarterly: (a) current subparagraph 8 (2) (c) (b) current subparagraph 8 (2) (d)"	
216.	ASSA	8(2)(b)	A derivative provider will not have insight into the full investment portfolio of a retirement fund, nor their investment strategy and intentions. As such a provider cannot be expected to provide "a statement confirming that derivative instruments are used for efficient portfolio management" from the fund's overall	See comments above at item 215 . Information must be provided to the fund in line with segregated portfolio mandates and fund's Investment Policy Statement

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			investment perspective. Onus is on the fund to ensure full details of investment objectives, fees and costs are supplied by the provider in terms of clause (3), and the fund should in terms of this then be able to ensure investment is made in accordance with their obligations in terms of 2(5) and the rest of the regulation as it pertains to efficient portfolio management. Suggestion: delete "a statement confirming that derivative instruments are used for efficient portfolio management," from the clause.	
217.	BASA		Should this refer to OTC derivatives only? As indicated on a number of the questions, it is not clear whether the Standard applies to OTC derivatives **only** or whether it includes exchange traded derivatives as well. The definition section only makes reference to OTC derivatives. However, the content of the document references "derivatives" in most cases. Please clarify.	The Standard applies to all types of derivatives in order to safeguard the assets of funds
218.	BASA	8(2)(a), (b) and (c)	Paragraph 8(2) (a), (b) and (c) is not information which an OTC derivative provider (in the sense of a counterparty) is in a position to provide Clarification is required if there is an expectation that ODPs would need to have a wholistic view of each pension fund with whom we trade to understand each pension funds compliance with Reg 28? ➢ Would suggest that it is not the banks/ODPs responsibility to monitor adherence to Reg 28 as	See amendments made to the Standard and comments above at item 215

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			we won't normally have the wholistic information to make the required assessment. Further, how is an ODP expected to make a statement regarding a pension funds efficient portfolio management again without the wholistic view of the pension fund's portfolio. Often pension funds have multiple segregated mandates with numerous asset managers who then trade their segregated portfolio with the banks/ODPs, which doesn't provide the banks/ODPs with a wholistic view but rather a limited transactional view. We recommend that the ODP obligations need to be limited to when they deal directly with a fund. Any obligations placed on the ODP must be included in the conduct standard for ODPs – it is not appropriate to be included here. In addition, all that is required in terms of the ODP regulations is the provision by the ODP of a portfolio reconciliation statement, containing certain detail around material economic terms, collateral and valuation. Clarity is required that this section does not seek to extend these requirements in a manner that would be out of scope of the current regulation (on the face of it, these requirements extend much further than the requirements set out in the Conduct Standard for ODPs).	
219.	BASA	8(2)(b)	Clarification is sought: Can an OTC derivative provider opine on whether the derivative instrument is used for efficient portfolio management – they may not have that insight to the fund. Presumably in that instance the Financial Service Provider will provide this. What	See comments above at item 215

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			happens in the instance where the Fund has not used a Financial Service Provider and has contracted directly with the OTC Derivative Provider – who makes this statement?	
220.	BASA	8(2)(c)	Clarification is sought: Would the OTC Derivative Provider have to prepare a report of the net exposure on all asset classes to / from the Fund to enable the Fund or Financial Service Provider to provide this statement. This surely can't be prepared by the OTC Derivative Provider because as they will not have sight of all the funds derivative exposures with various counterparties	See comments above at item 215
221.	Futuregrowth	8(2)(c)	It would be more prudent to reflect exposures on a gross basis per counterparty, Netting should only really come into play if there is an event of default on any particular counterparty. This does not negate the provisions for netting as contemplated in clause 6	Where netting is used the provisions of the netting must be applied
222.	BASA	8(2)(d)	It appears that the requirement to establish a methodology rests with the Fund however clause 8(2)(d) requires the Financial Service Provider or OTC Derivative Provider to make a statement confirming that the valuation methodology has not changed. ➢ Is the intention that the Financial Service Provider or OTC Derivative Provider align to the Funds methodology? (This may not be possible) or is the fund to align their methodology to the Service Providers / OTC Derivative Providers methodology which may differ.	See amended wording including OTC derivative provider valuations as well as comments above at item 215

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			Obviously other changes other than methodology, dividend assumptions, changes to the swap curve, changes to volatility assumptions would all impact valuation. We assume these are not envisaged here as it would have formed part of the transparent methodology process established in paragraph 2?	
9. REPEAL, COMMENCEMENT AND SHORT TITLE				
223..	ASISA		Funds should have an appropriate time period after the publication of the requirements to review its current policies, processes, and procedures to ensure compliance with the requirements set by the Conduct Standard. While most of the requirements are similar to current market practice, the operational capacity of industry participants to implement reviewed or new requirements are constrained mostly by alternative working arrangements implemented in response to the Covid-19 pandemic. ASISA members respectfully request an implementation period of 9 months. Proposed wording: This Conduct Standard is called Conditions for Investment in Derivative Instruments for Pension Funds, 2020 and takes effect ~~six~~ nine months after publication. Please also refer to the response to questions 3 and 5 in Part C of this comments document in relation to transitional arrangements.	Agree, commencement period has been amended to 12 months

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224.	Legae	Definitions effective economic derivatives exposure AND Net effective exposure (not used in current draft ALSO Paragraphs 2(2), 2(3), 2(4), 5(1), 6(1), 6(3), 8(2)(b), And other paragraphs	The regulation seems to regulate three “exposures” - Counterparty exposure - Net derivative exposure (as a stand-alone concept) e.g. 2(2), 2(3), 2(4) - Net derivative exposure combine with the underlying assets (mainly to measure compliance with regulation 28) e.g. 5(1), 6(1), 6(3), 8(2)(b) The terminology / definitions are not consistently used and creates ambiguity, including potential ambiguity with regards to allowable netting - Between derivatives as a standalone netting exercise and - Between derivatives and physical assets	See specific comment above and amended wording especially to definitions section and alignment
225.	FIA	Derivatives held through a CIS	This Conduct Standard does not cover derivatives that may be held indirectly through a CIS. In terms of Reg28, there is a requirement to look through the CIS. We request clarity regarding indirect holdings.	See specific comment above and amended wording especially to definitions section and alignment
226.	PSG	Derivatives held through a CIS	The attached conduct standard does not cover derivatives that may be held indirectly through a CIS. In terms of Regulation 28, there is a requirement to look through the CIS. We kindly request clarity regarding indirect holdings.	See look though principle regulation 28(4) references in responses above
227.	IRFA		**Confirmation on the application of this draft Conduct Standard is requested:**	See amended wording and responses Above

#	Commentator	Issue	Comment/Recommendation	
			a) It has been issued in terms of PFA Regulation 28(7), which reads *28(7) Derivative instruments* *Notwithstanding subregulation 3(d), a fund may invest in derivative instruments subject to conditions as prescribed*. b) Derivative instrument is defined to have the meaning assigned to it in Section 1 of the Securities Services Act, 2004 (Act No. 36 of 2004), which Act was replaced by the Financial Markets Act and defines it as follows: *derivative instrument" means any-* *(a) financial instrument; or* *(b) contract,* *that creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate or index, on a measure of economic value or on a default event;* c) The wording in sections 6(a) and (b) of the draft conduct standard is clear that this conduct standard applies where a fund	

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			• Has mandated a FSP or OTC provider to investment in a derivative instrument on behalf of the fund • Invests into a derivative instrument directly d) Therefore this conduct standard does not apply in the instances where the fund has a market related or linked policy with a life insurer and the life insurer invests in derivatives instruments on its own accord. This conduct standard will apply to funds who have derivatives instruments included in the fund's Investment Policy Statement and invest in such derivatives either through a mandate to a FSP or OTC or directly by the fund. • Attached is the email with the then FSB responses to the comments submitted on the 2013 version of the notice. • The submission made on 2.18 states *With the look-through principle in mind, in the case of a retirement fund investing solely in collective investments schemes or a linked policy which may contain derivatives, the retirement fund will not be able to instruct the collective investment scheme or insurer to sell, liquidate or close out a derivative instrument at any time. It is thus suggested that this principle only be applicable where the fund directly holds the derivative instrument.* The FSB response was *Agreed, see revised wording*	See look though principle regulation 28(4) References in responses above and proposed amendments to Regulation 28(4) underway

SECTION B - GENERAL COMMENTS				
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228.	WWC Asset Management		Whilst we are wholeheartedly in support of the main objectives in the draft namely; to ensure that the correct framework in which to trade, settle, value and monitor the risks of derivative usage in a transparent, fair and balanced manner, we would like to raise the following: At this point in time there has been incomplete implementation in south Africa of the 2009 G20 suggested reform that aimed to improve transparency, mitigate systemic risk and reduce market abuse by: • Reporting OTC derivatives contracts to Trade Repositories (TRs), • Trading standardised contracts on exchanges or electronic trading platforms, • Clearing standardised contracts through central counterparties (CCPs), where appropriate, and • Subjecting non-centrally cleared derivatives contracts to higher capital and margin requirements. Market participants must therefore ask if limiting the usage of derivative instruments, specifically Over the Counter (OTC) by Pension Funds without the completion of the above framework is prudent? Even with the publication of the Joint Standard 2 of 2020, many participants are wondering how this will work without Trade Repositories. Many other pieces of legislation will have to be reworded to include the placing of collateral and pledging of assets where currently encumbrance of assets is prohibited. The main desire of all market participants is a level playing field with fair and balanced regulation and legislation. Derivatives have their use within pension funds if used prudently, and if correctly monitored.	See specific comment above and amended wording especially to definitions section and alignment effected to the Standard

#	Commentator	Issue	Comment/Recommendation	
			Specifically introducing a limit of 25% as per section **2 Use of derivative Instruments (3) (b)** of the value of the total value of the fund's assets is vague and unclear. It also negates the purpose of an inclusive Risk Management Policy, agreed upon *daily (which would be our recommendation, instead of* monthly) valuation methodology and managing *unsettled* counterparty exposures. Also, what is the agreed definition of "value"? By subjecting funds to specific limits on utilising derivative instruments, in no way addresses the issues of transparency, liquidity and risk mitigation for investors or market participants. The introduction of a central repository, as per the suggested guidelines would allow a single and manageable viewpoint into the market that could be monitored on a real time basis. This could if need be margined, thereby allowing derivative instruments to be used, for the correct purpose in efficient portfolio construction without having to set outright limits on the amount of a derivative that may be used in a portfolio. In summary, ensuring the derivative market structure is set up correctly in accordance with the G20 premise, that the fair and allowable usage of collateral and margining systems by *all* market participants (not just specifically Pension Funds) is the best way to minimise the risks associated with derivative instrument usage. Allow derivatives to be used for risk mitigating or efficient portfolio construction correctly without impacting the freedom of users to manage their own investment objectives and outcomes. Once again, we support market reform that creates a safer investment	

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			environment and remain available to engage on the next drafts of derivative usage proposals.	
229.	JSE		The JSE welcomes the opportunity to provide comment on the Draft Conduct Standard – Conditions for investment in derivatives. We acknowledge the important role that the Authority plays in the protection of vulnerable investors, such as pension fund members and beneficiaries. We appreciate the necessity for the FSCA to prescribe appropriate conditions for pension funds when investing in derivative instruments, and we respectfully urge the Authority, in the determination of the final conditions for investment in derivatives, to collaborate with industry fora and market practitioners who have developed and implemented sound and prudent market practices, post the global financial crises and in the last decade.	Comments noted
230.	RisCura	Regulation 28 reporting to the FSCA	Many of our comments relate to issues created by the Schedule IB reporting of Regulation 28. Accordingly, we would like to raise our observations so that the comments below have context. Currently, the standard format of Regulation 28 compliance reporting is Schedule IB to the annual financial statements. (As the quarterly reporting is limited to breaches, and a majority of funds therefore don't report on it, we will not be commenting on it further). Schedule IB was based on the reporting format used under old Regulation 28 and so the reporting is at a point in time and looks at the total fund only. Furthermore, there are	See revised AFS notes and RRR (accounting framework) to be issued for public comment. Also see note G1 & G2 of AFS

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			misalignments between Regulation 28 and Schedule IB as the former subordinates all definitions of "foreign" to the SARB and the latter mandates reporting of "foreign" in subcategories which are not always consistent with the Regulation (see in particular "foreign" cash). Inevitably, this has led to monitoring of Regulation 28 compliance being done in accordance with the reporting under Schedule IB (particularly since this is what is audited), and not necessarily in accordance with the Regulation itself. While this is not always the case – there are Funds who strive to comply with the legislation rather than the reporting – many Funds have defaulted to the "easiest" way of point-in-time evaluation. We submit that this reporting needs to be re-considered and that the derivatives conduct standard would lose some of its effectiveness (and indeed, in some instances, not be possible to implement without attracting a modified audit opinion on Schedule IB) unless these issues are resolved. With regards to derivatives, the following areas are of particular concern: - Alignment with SARB treatment & definitions - Need for more than one reporting "basis" – effective exposure and counterparty exposure cannot be disclosed in the same "table". - Treatment and disclosure of notional adjustment to get from physical to effective exposure.	See specific comment above and amended wording especially to definitions section and alignment to FMA., FAIS Act, Insurance Act, SARB Margin requirements, international standards, etc.

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#	**Commentator**	**Issue**	**Comment/Recommendation**	
231.	RisCura	Alignment with SARB	One of the practical difficulties retirement funds face is the misalignment between the Reserve Bank's treatment of derivatives (physical) and Regulation 28's treatment of derivatives (effective). We have observed the following outcomes as a result: - For Funds with a young membership profile and therefore an aggressive investment strategy (including maximum utilisation of offshore allowances), SARB breaches occur while Regulation 28 reporting indicates compliance. This is largely due to the exposure effect of currency derivatives or derivatives with foreign reference assets not being recorded using effective economic exposure under the SARB framework. Confusion for Boards of Funds when reporting under one framework indicates compliance and reporting under the other framework indicates a breach	See specific comment above and amended wording especially to definitions section and alignment effected in the Standard
232.		Reporting – conflation of effective economic exposure and counterparty risk	The starting point for any of the reporting under Regulation 28 is the fair market value of the Fund's assets. Under any reporting framework, this will always be 100%. The problem with counterparty exposure reporting is that, with the same investment, a Fund might have exposure to multiple counterparties. This is true even in a "vanilla" CIS. If a Fund has a participatory interest in an equity CIS, for example, it has counterparty/credit exposure both to the CIS itself **and** to the issuers of the underlying securities (on a look-through basis). In this example, aggregated reporting	See specific comment above and amended wording especially to definition section and alignment effected in the Standard

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#	**Commentator**	**Issue**	**Comment/Recommendation**	
			(like Schedule IB) whereby all exposures must add up to 100% is not possible. Rather, each of the exposures should be evaluated separately against the relevant Regulation 28 limit. This is particularly important when evaluating derivative counterparty exposure as many derivative counterparties are financial institutions and so a Fund would most likely have exposure to that counterparty in other assets. Accordingly, we propose that a Fund needs to evaluate effective economic exposure of derivatives on an aggregated, full look-through basis and, further, needs to evaluate counterparty risk on a non-aggregated basis (with varying levels of look through & effective economic exposure). Accordingly, the reporting under Schedule IB may need to be revisited by the Authority.	
233.	RisCura	Reporting – treatment of notational adjustment	In aggregated reporting when the effective economic derivative exposure to the reference asset is included, this inclusion cannot change the total fair value of the Fund. As such, a notional adjustment cash backing / “instrument” is created. The draft Conduct Standard does not prescribe how and where this should be evaluated and, to avoid inconsistent treatment, we are of the view that the treatment of this “instrument” should be inserted. We believe that the most appropriate place for this notional adjustment is cash.	See specific comment above and amended wording especially to definition section and alignment effected in the Standard

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234.	Khumo Capital	Efficient portfolio management strategies other than Hedging strategies	As highlighted in our comments in section 2. Uses of derivative instruments, subclauses 2(2) and 2(3)(a) needs to be expanded to also address long derivative positions, e.g. long forward or call option positions that are covered by cash type assets. These strategies play a very important role in reducing the cost for pension funds, e.g. obtaining exposure in a specific asset class in a cost-efficient manner. The asset that the derivative exposure is covered by, i.e. the appropriate reference asset for short positions and cash type assets for long positions, needs to be defined.	See comments above
235.	Khumo Capital	Asset class exposure risk relative to counterparty risk	The effective economic exposure of a derivative instrument reflects the asset class exposure risk of the instrument whilst the fair value of the derivative reflects the counterparty exposure risk at any point in time. These are two very distinct risks and a dual reporting framework needs to be specified accordingly, as highlighted in our first comment on 5(2) above. Clear guidance needs to be provided on what restrictions apply in terms of counterparty / fair value exposure (see second comment to 5(2) above).	See comments above
236.	Khumo Capital	Cash adjustment	When reporting the effective economic derivative exposure, which differs from the fair market value of the derivatives, must an adjustment (increase / decrease) be made to the Cash category in order for the total Regulation 28 value of the fund's assets to match the total fair market value of the fund's assets?	See comments above