

# **Statement\* of the need for, expected impact and intended operation of regulatory instrument:**

## **Draft Joint Standard – Requirements relating to central counterparty licence applications (Draft Joint Standard)**

**December 2019**

\* This statement is prepared and published in accordance with and in fulfilment of the requirements under section 98(1)(a)(ii) and (iii) of the Financial Sector Regulation Act, No. 9 of 2017

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## **1 Introduction**

- 1.1 In terms of section 98 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSRA), a financial sector regulator must not make a regulatory instrument<sup>1</sup> unless it has published the following documents:
- (i) a draft of the regulatory instrument;
  - (ii) a statement explaining the need for and the intended operation of the regulatory instrument;
  - (iii) a statement of the expected impact of the regulatory instrument; and
  - (iv) a notice inviting submissions in relation to the regulatory instrument, stating where, how and by when submissions are to be made.
- 1.2 In fulfilment of the above-mentioned requirements, the Financial Sector Conduct Authority (FSCA) and Prudential Authority (PA) (collectively referred to as the Authorities) have prepared a statement of the need for, intended operation and expected impact of the draft Joint Standard – Requirements relating to central counterparty licence applications.

## **2 Statement of the need — context and definition of policy problem**

- 2.1 The FMA defines a central counterparty (CCP) as a clearing house that interposes itself between counterparties to transactions in securities, becoming a buyer to every seller and the seller to every buyer and thereby ensuring the performance of open contracts. A CCP becomes a counterparty to trades with market participants through novation, an open offer system or through a legally binding agreement.
- 2.2 CCPs have become systemically important since measures to mandate central clearing of over-the-counter (OTC) derivatives have been introduced. CCPs are recognised for the pivotal role in reducing systemic risk through centralised risk management, and multilateral netting and risk mutualisation capabilities that contribute to reducing total counterparty risk exposure.
- 2.3 The cross-border nature of securities markets requires an appropriate regulatory framework that promotes the efficiency and competitiveness of the South African financial markets without significantly undermining their stability.

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<sup>1</sup> For the purpose of this Statement, the reference to a regulatory instrument refers to the draft Joint Standard

- 2.4 In order to facilitate the G20 central clearing obligation, matters that deal with CCPs were introduced into law through the FSRA as consequential amendments to the Financial Markets Act, 2012 (Act No. 19 of 2012) (FMA).
- 2.5 In addition, Ministerial Regulations (Regulations)<sup>2</sup> were made under sections 5(1), 8(1)(a), 28(1)(a), 48(1)(a), 48(1A), 49A, 53(2A), 55(1)(a), 56A and 107 of the FMA to –
- enhance the governance, operational and risk management requirements for market infrastructures; and
  - set requirements for CCPs.
- 2.6 The Regulations insofar as they relate to CCPs introduced a rigorous framework for their regulation and contain stringent prudential, governance and conduct requirements. The proposed regulatory regime is designed to be consistent with international best practice, and to preclude entities which are not capable of meeting the standards required to perform the critical CCP function.
- 2.7 There are, however, currently no CCPs licensed in South Africa and any clearing house that is performing the functions of a CCP will be required to undergo a licensing process to operate as a CCP.
- 2.8 In addition, in December 2012, the Registrar of Securities Services approved JSE Clear as a Qualifying Central Counterparty (QCCP) for listed derivatives on the basis that JSE Clear complies with the Principles for Financial Markets Infrastructures (PFMIs) and the requirements set out in the FMA.
- 2.9 Although section 47 of the FMA sets out a high-level licensing framework for CCPs, section 47(3) of the FMA enables the Authorities to prescribe the licensing process in more detail. This licensing process has not yet been prescribed by the Authorities. Section 47 of the FMA provides as follows:
- 2.9.1 Section 47(2) of the FMA provides that a juristic person may apply to the Authority for a clearing house licence or a central counterparty licence.

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<sup>2</sup> The Ministerial Regulations were published under Government Notice R98 in Government Gazette 41433 of 9 February 2018

2.9.2 Section 47(3) of the FMA provides that an application for a clearing house licence or central counterparty licence must (emphasis added) -

- (a) be made in the manner and contain the information prescribed by the Authority;
- (b) *show that the applicant complies with the requirements listed in section 48;*
- (c) *be accompanied by-*
  - (i) *a copy of the founding documents of the applicant;*
  - (ii) such information in respect of members of the controlling body of the applicant as may be prescribed by the Authority;
  - (iii) *the application fee determined in terms of the Financial Sector Regulation Act;*
  - (iv) *in relation to an application for an associated clearing house licence, particulars of the applicant's proposed appointment by an exchange; and*
  - (v) *in relation to an application for an independent clearing house licence or a central counterparty licence, a copy of the proposed clearing house rules that must comply with section 53; and*
- (d) be supplemented by any additional information that the Authority may reasonably require.

2.10 As there is currently no licensing framework prescribed for CCPs, there is a need for the Authorities to prescribe, through a joint standard, a licensing framework for CCPs as enabled through section 47(3) of the FMA.

2.11 This essentially means that no CCP can be licensed before the licensing framework has been finalised.

2.12 In addition, section 110(6) of the FMA provides that a clearing house performing the functions of a CCP must comply with any requirements imposed by regulations or standards and must until 31 December 2021, be licensed as either an associated clearing house or an independent clearing house and must obtain the necessary approvals as contemplated in the FMA Regulations at the time of submitting its application to be licensed as a CCP.

### **3 Objectives of the proposed Joint Standard**

- 3.1 The content of the draft Joint Standard relates to the manner in which an application for a CCP licence referred to in section 47(2), read with section 47(3), of the FMA must be submitted, and the information that must be contained in such application.
- 3.2 The information that must accompany a CCP licence application is set out in the Joint Standard and includes –
- (a) administrative information;
  - (b) founding documents of the applicant;
  - (c) additional information which must be contained in an application for a central counterparty licence;
  - (d) details of the compensation funds of the applicant; and
  - (e) proof of compliance with the FMA Regulations.

### **4. Statement of expected impact – Costs and benefits of the Joint Standard**

- 4.1 While the compliance with the proposed Joint Standard will have some administrative costs on CCP licence applicants, it is envisaged that the Joint Standard will not have a material adverse impact on the applicants. The requirement to be licensed as a CCP is already contained in the FMA and the purpose of the Joint Standard is merely to prescribe the procedures to be followed when applying for such licence.
- 4.2 The Authorities acknowledge that this is a preliminary desktop assessment of the potential impact of the draft Joint Standard and that subject to additional input that may be submitted by affected stakeholders as part of the comments process, this Statement may be updated accordingly. Commentators should therefore clearly identify the risks, benefits and impacts of the draft Joint Standard in **Section C** of the comments template.

### **5. Statement of intended operation**

- 5.1 The draft Joint Standard applies to any person seeking to be licenced as a CCP and the content of the draft Joint Standard is consistent with the objects of the FMA and the FSRA, and specifically the mandate of the Authorities.

- 5.2 The Authorities will evaluate compliance with the draft Joint Standard during the assessment of CCP applications received under section 47(2) of the FMA.
- 5.3 It is envisaged that the Joint Standard will be implemented during the third quarter of 2020 which will enable the Authorities to consider licence applications.
- 5.4 Following the implementation of the Joint Standard, the Authorities will assess and evaluate the effect of the Joint Standard on a continuous basis as part of the regulators' supervisory responsibility to ensure that any unintended consequences of the Joint Standard on the industry are adequately addressed.

## 6. Way forward

- 6.1 The draft Joint Standard is published in terms of section 98(1) and (2) of the FSRA for public comment for a period of 6 weeks, and comments are due to the Authorities on or before 21 February 2020. All submissions must be submitted via email to [FSCA\\_RFDStandards@fsca.co.za](mailto:FSCA_RFDStandards@fsca.co.za) for the attention of Mr Eugene du Toit and to [PA-Standards@resbank.co.za](mailto:PA-Standards@resbank.co.za) for the attention of Ms Lyle Horsley.
- 6.2 After careful consideration of all submissions received on the draft Joint Standard, the Authorities will make any necessary changes to the draft Joint Standard and submit the updated draft Joint Standard to Parliament for a period of at least 30 days while Parliament is in session.<sup>3</sup>
- 6.3 Please note that this statement supporting the publication of the draft Joint Standard for public consultation may be updated to better reflect the expected impact of the draft Joint Standard based on the submissions that shall be received **under Section C** of the comment template.

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<sup>3</sup> Assuming no material changes to the draft Joint Standard is required necessitating another round of public consultation.