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TO:

Mr. AJ Smal
South African Reserve Bank
Office of the Registrar or Banks
Via email: SARB-banksup@resbank.co.za

7 December, 2016

Re: 15/8 Proposed Directive issued in terms of section 6(6) of the Banks Act of 1990 regarding margin requirements for non-centrally cleared derivatives

Dear Mr. Smal,

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) welcomes the opportunity to comment on behalf of its members on the "Proposed Directive issued in terms of section 6(6) of the Banks Act of 1990" (the Proposal) issued by the South African Reserve Bank Registrar of Banks (RB) on 21 November, 2016.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 25 global foreign exchange (FX) market participants,[1] collectively representing around 85% of the foreign exchange inter-dealer market.[2] Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

The FX market is the world's largest financial market and effective and efficient exchange of currencies underpins the world's entire financial system. Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasise the desire of our members for globally coordinated regulation which we believe will be of benefit to both regulators and market participants alike.

[1] Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi, Barclays Capital, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Mizuho, Morgan Stanley, Nomura, RBC, RBS, Scotiabank, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

[2] According to Euromoney league tables.

The FX market is also the basis of the global payments system. The volume of transactions is therefore very high and these transactions are often executed by market participants across geographical borders. As reported by the Bank for International Settlements (BIS) in their 2016 Triennial Central Bank Survey: Foreign Exchange Turnover in April 2016, over 77% of FX activity was executed by market participants across five global jurisdictions,[3] hence the strong view from the GFXD that regulations should be harmonised at the global level. Cross border markets cannot operate in conflicting regulatory landscapes and the natural outcome, should this be the case, is unwanted fragmentation of what is an already highly automated and transparent FX market.

EXECUTIVE SUMMARY

We fully support the RB taking initiatives to implement the G20 commitments to reform the OTC derivative markets. We highlight below, however, three key points arising out of the Proposal that are of particular concern to our members from an FX perspective, and that we ask that the RB take into account in finalizing the Proposal.

To summarise:

1. A preferable and more globally consistent approach to variation margin for physically-settled FX forwards and swaps would be to establish variation margin requirements for these products via reference to the 2013 BCBS FX Supervisory Guidance.
1. We are concerned that the current implementation timeline proposed does not provide sufficient lead time, given the legal and infrastructure needs and challenges with preparing for exchange of margin between parties to FX transactions.
2. We urge that FX "security conversion transactions" (as defined below) entered into in connection with the funding of a purchase or sale of a foreign security be deemed spot transactions and therefore not included within the scope of derivatives regulation in South Africa, including uncleared margin requirements, even if settled on a longer than T+2 basis.

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We set out below more detailed explanations of our concerns.

1. **<u>Margin requirements for deliverable FX transactions</u>**

The GFXD welcomes and supports the RB's exemption of physically-settled FX forwards and swaps from the initial margin requirements in the Proposal. As indicated in the March 2015 *Margin requirements for non-centrally cleared derivatives* by the Basel Committee on Banking Supervision and International

[3] BIS 2016 Triennial Survey: http://www.bis.org/publ/rpfx16.htm, see pp.8 and 14.

Organization of Securities Commissions (the International Margin Framework),[4] these products merit exclusion from the scope of the margin requirements due to their unique characteristics.

However, in order to avoid inconsistency with the treatment of physically-settled FX forwards and swaps in other jurisdictions, potentially creating an uneven playing field and incentivizing regulatory arbitrage, we urge the RB to exclude physically-settled FX forwards and swaps from the scope of the variation margin provisions as well.

The International Margin Framework excepts physically-settled FX forwards and swaps from its margin requirements entirely, although stating that standards apply for variation margin for physically-settled FX forwards and swaps[5] and citing the 2013 "BCBS Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions" (FX Supervisory Guidance, see Guideline 3 – Replacement cost risk).[6]

The RB's application of the variation margin requirements to physically-settled FX forwards and swaps would contrast with the treatment of these deliverable FX products in the US, Japan, Singapore, Canada and Australia. Physically-settled FX forwards and swaps are excluded from <u>both</u> initial and variation margin requirements under the final US Prudential Regulators' Rules, US CFTC Rules, Canadian, Japanese and Australian uncleared margin rules. The uncleared margin proposals in Singapore also exclude physically-settled FX forwards and swaps from both initial margin and variation margin requirements. We are in discussions with the Hong Kong regulators urging them to do the same.

An important element of the International Margin Framework is the goal of promoting global consistency and reducing regulatory arbitrage opportunities with respect to the treatment of physically-settled FX forwards and swaps. If jurisdictions are to differ in their approach to physically-settled FX forwards and swaps, this may well result in different requirements applying across borders. If this were to result, we would have significant concerns about potential impacts on pricing and liquidity.

In light of the above, in order to achieve better global consistency across jurisdictions, both to maintain the competitiveness of entities subject to the RB's margin requirements and to avoid potential jurisdictional conflicts, in our view a preferable and more globally consistent approach to variation margin for physically-settled FX forwards and swaps would be to exclude physically-settled FX forwards and swaps from the Proposal, and instead establish any variation margin requirements for such FX forwards and swaps via reference to the FX Supervisory Guidance.

For example, in Singapore the Monetary Authority of Singapore (MAS) in its October 2015 Policy Consultation on Margin Requirements for Non-Centrally Cleared OTC Derivatives states that

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[4] Available at http://www.bis.org/bcbs/publ/d317.htm

[5] See http://www.bis.org/bcbs/publ/d317.htm (see p.7)

[6] Available at http://www.bis.org/publ/bcbs241.pdf

physically-settled FX forwards and swaps are exempted from the margin requirements, but that entities are expected to appropriately manage the risks associated with such FX transactions, referencing the BCBS FX Supervisory Guidance.[7] In Canada, physically-settled FX forwards and swaps are excluded from the entirety of the uncleared margin requirements,[8] however the Office of the Superintendent of Financial Institutions Canada (OSFI) has separately issued an Advisory which establishes OSFI's expectations regarding the management of FX settlement risk by banks, on the basis of the BCBS FX Supervisory Guidance.[9] In the US, the BCBS FX Supervisory Guidance is adopted by way of a Federal Reserve System Supervisory Letter.[10]

2. Implementation schedule

The introduction of margin requirements for uncleared FX transactions is a significant policy change for most FX market participants. These new requirements will call for legal and operational enhancements, and additional amounts of collateral for which liquidity planning will have to be undertaken by covered entities within scope of the margin rules.

Although the RB contemplates a phasing-in of margin requirements, we are concerned that the 1 January, 2017 start date for first phase entities to comply with the margin requirements does not provide sufficient lead time. Final rules are required before firms will be able to begin necessary work, including legal, documentary, technology systems, operational and risk management work, and even once this works begins, time will be needed for testing.

To avoid what could be significant disruption to the FX market, we urge the RB to provide further lead time before the margin rules take effect, so that there is the opportunity for covered entities' legal and infrastructure needs and challenges to be properly and adequately addressed.

3. Exclusion of FX transactions linked to securities settlements from the margin requirements

We also urge that FX transactions that are incidental to and for the purpose of effecting customers' foreign security transactions, entered into in connection with the funding of a purchase or sale of a foreign security (FX security conversion transactions), be deemed spot transactions and therefore not included within the scope of derivatives regulation in South Africa, including uncleared margin requirements, even if they are settled on a longer than T+2 basis. We note that in South Africa, for example, securities settlement cycles can take up to seven days (T+7).

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[7] See http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/Policy%20Consultation%20on%20Margin%20Requirements%20for%20NonCentrally%20Cleared%20OTC%20Derivatives%201Oct.pdf (Footnote 7)

[8] See http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e22.aspx#01 (see para. 20)

[9] See http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/adv-prv/Pages/FXSR.aspx

[10] See http://www.federalreserve.gov/bankinforeg/srletters/sr1324.htm

In this regard, we refer to our letter dated 31 August, 2016 to Ms. Petula Sihlali at the South African National Treasury on the Third Draft of the Ministerial Regulations on Regulating OTC Derivative Markets: http://www.gfma.org/correspondence/item.aspx?id=838.

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We appreciate the opportunity to share our views on the Proposal. Please do not hesitate to contact Andrew Harvey on +44 20 3828 2694, email aharvey@gfma.org or Victoria Cumings on +1 212 313 1141, email vcumings@gfma.org, should you wish to discuss any of the above.

Yours sincerely,

James Kemp
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