



South African Reserve Bank
Office of the Governor

Mr Yunis Carrim (MP)
Chairperson: Standing Committee on Finance
National Assembly
Parliament of the Republic of South Africa
90 Plein Street
Cape Town
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Cc: Mr Allan Wicomb
Committee Secretary

Per email: awicomb@parliament.gov.za

Dear Mr Carrim

**REQUEST FOR URGENT PROCESSING OF AMENDMENTS TO THE
INSOLVENCY ACT IN THE FINANCIAL MATTERS AMENDMENT BILL**

The above captioned subject matter refers.

South Africa decided to implement the internationally agreed framework for the margin requirements for non-centrally cleared over-the-counter (OTC) derivative transactions (Margin Standard), in order to mitigate the potential systemic risks from non-centrally cleared OTC derivative transactions and to reduce contagion and spillovers to the SA financial system. The South African Reserve Bank (SARB) and the Financial Sector Conduct Authority (FSCA) are preparing for the final round of public consultation on the Margin Standard and are aiming to have the Margin Standard become effective on 1 September 2019.

In the 13th Progress Report issued by the Financial Stability Board on OTC Derivatives Market Reforms during October 2018, South Africa was highlighted as one of the few jurisdictions that had not implemented the margin requirements and was urged to redouble efforts to finalise the implementation of the margin requirements in its jurisdiction. The delay in finalising the Margin Standard is attributable to the current incompatibility between the proposed requirements in the Margin Standard framework and the provisions in the Insolvency Act.

One critical aspect of the Margin Standard is the requirement for the bilateral (i.e. two way) exchange of initial margin. In terms of the Margin Standard, initial margin must be held in such a way that it is immediately available to the collecting party in the event of the counterparty's default and must be subject to arrangements that fully protect the party that posts margin in the event that the collecting party is insolvent.

Market participants will not be in a position to comply with the initial margin requirements in the Margin Standard based on the current Insolvency Act. More specifically, in terms of the current Insolvency Act, when a market participant defaults, the non-defaulting party will not be able to retain the proceeds of the realised collateral (initial margin) that serves to protect the non-defaulting party in the event of a counterparty default, because the non-defaulting party would need to pay the proceeds from the realised collateral to the Master or the trustee of the insolvent's estate.

The National Treasury, in consultation with the Department of Justice and Constitutional Development, the Master's Office, the SARB and the FSCA, has therefore proposed urgent amendments to the Insolvency Act to ensure that the Margin Standard can be implemented in South Africa. On your instruction, numerous engagements taken place with the commentators on the proposed amendments to the Insolvency Act and the industry is comfortable with the revised proposals which will be presented to Parliament on 6 March 2019.

If the proposed amendments to the Insolvency Act are not processed as part of the Financial Matters Amendment Bill, there will be serious ramifications for local market participants and South African financial markets more broadly. To this end, South African market participants will start falling within scope of the thresholds set out in the margin requirements in foreign jurisdictions and will therefore be required to exchange (post or collect) margin with foreign counterparties. To the extent that the South African Insolvency framework does not allow the initial margin to be immediately available in the event of a counterparty default, the foreign counterparty will not be in a position to comply with its margin requirements in its home jurisdiction and will therefore not enter into a non-centrally cleared OTC derivative transaction with local market participants. Such an outcome will have major implications for SA entities' ability to transfer risk offshore (in order to reduce systemic risk in South Africa) instead of concentrating risk in the South African financial markets.

The SARB has further been advised that a number of international banks have sought legal advice on whether to close out their trading positions with South African banks based on the opinions that have been prepared for the International Swaps and Derivatives Association Inc (ISDA) on the validity and enforceability under our laws of margin or collateral arrangements entered into under the standard form documents published by ISDA (including master agreements for OTC derivative contracts).

The SARB therefore wishes to reiterate that if the Insolvency Act is not amended as part of the Financial Matters Amendment Bill, the Margin Standard will not be enforceable and parties will have uncollateralised exposures to one another, thereby increasing systemic risk in the SA financial system. South Africa will also fall short of its G20 commitments to make derivative markets safer as part of the global response to the great financial crisis.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Lesetja Kganyago', written in a cursive style.

Lesetja Kganyago
Governor

Date: 6 March 2019

CC: Mr Tito Mboweni (MP)
Minister of Finance
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