LCH.CLEARNET

National Treasury
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BY EMAIL: financial.policy@treasury.gov.za

Our ref 0080743-0000045 JH:135254.4

10 July 2015

Dear Sirs

Financial Markets Act, 2012: Ministerial Regulations (Round Two)

1. Introduction

1.1 This letter provides the comments of LCH.Clearnet Limited (**LCH.Clearnet**) on the second draft of the Ministerial Regulations published under the Financial Markets Act 2012, (**FMA** and this the **Second Draft**) supporting the objects of the FMA and South Africa's commitment to the G20 obligations in terms of regulatory reforms for over-the-counter derivatives market.

1.2 The description of the corporate structure and business of LCH.Clearnet is as per our submission dated 3 September 2014 a copy of which is attached for your records (**First Submission**). Capitalised words not defined herein shall have the same meaning as in the First Submission.

1.3 We are grateful for the opportunity to comment on the Second Draft Policy Document accompanying the Ministerial Regulations and Board Notices issued under the Financial Markets Act (**Second Draft Policy Document**) and welcome the equivalence regime for international central counterparties as specified in the Second Draft Policy Document. We are considering the options for central clearing contained in the Second Draft Policy Document which are relevant to LCH.Clearnet as an International central counterparty. We will provide you with any feedback which we believe may be of importance to you especially giving the experience of LCH.Clearnet in ZAR transactions as part of our global liquidity pool (LCH.Clearnet currently clears approximately 60% of the ZAR Interest Rate Swaps Market with notional outstanding of approximately ZAR 12.4 Trillion, alongside a clearing service in 17 global currencies).

1.4 As you are aware LCH.Clearnet is a subsidiary of LCH.Clearnet Group (**Group**) which is one of the world's largest clearing house groups. As such LCH.Clearnet is able to draw on central clearing expertise in a number of jurisdictions. Integral to the business model of the Group is the very high priority we attach to ongoing co-operation with the relevant regulators in each jurisdiction where the Group's central counterparties operate. LCH.Clearnet is currently licensed to provide the SwapClear service in multiple jurisdictions including: UK, Europe, US, Australia, Canada and has applied for authorisation in a number of other jurisdictions.

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1.5 We have considered the Second Draft and our comments are below.

2. The Second Draft

2.1 **Regulations 24(2)(c) to (m) – Qualifying Capital**

(a) The deductions in relation to those items listed in sub-regulations (c) to (m) are not necessary as capital is already limited by financial resources not invested in cash or highly liquid securities as specified in sub-regulation (2)(a). Including the deductions in sub-regulations (c) to (m) would therefore result in double counting. As such, we recommend that sub-regulations (c) to (m) are deleted.

(b) In addition, it would make sense to include in sub-regulation (2) own resources as a deduction (not limited to own resources used to contribute to the default fund) with a cross reference to regulation 41(2)(a).

2.2 **Regulation 27 – Specific capital requirements for business risk and for winding down or restructuring**

(a) Sub-regulation (1) requires a central counterparty to submit to the Registrar of Securities Services (**Registrar**) for approval its estimate of the capital necessary to cover losses resulting from business risk. A foreign central counterparty regulated by existing regulatory frameworks such as EMIR is already required to submit business risk models and wind down plans to its local regulator and as such this seems to be an unnecessary duplication for a foreign central counterparty. As such we would prefer this requirement to be removed for a foreign central counterparty where such foreign central counterparty is already required to submit business risk models and wind down plans to its local regulator.

(b) Sub-regulation (2) requires a minimum capital requirement for business risk of 6 months operating expenses. In terms of many existing regulatory frameworks this requirement is only 3 months operating expenses. We request that this capital requirement is brought into line with the capital requirements for foreign central counterparties as imposed by their home regulator as this would otherwise have a very significant impact on foreign central counterparties.

2.3 **Regulation 35 – Consolidated Supervision Requirements**

We note the response of National Treasury (Treasury Response) to our comment in the First Submission in relation to Regulation 45 of the First Draft (Consolidated Supervision Requirements). We note that there is no definition of "controlling company" in either the Regulations or the FMA. As such, we whilst we accept that the immediate controlling company of the central counterparty should be included in any consolidated supervision, such consolidated supervision should not extend to the shareholders of the immediate controlling company of a central counterparty who themselves are not subject to consolidated supervision for regulatory capital purposes. It would be helpful if clarity is given in this regard.

2.4 **Regulation 36 – Segregation and Portability**

(a) In our comment in the First Submission relating to Regulation 47(1)(a) in the First Draft (*Segregation and Portability*), we noted that a central counterparty is only able to provide the

protection envisaged therein to the extent that the identity of the client of a clearing member is known to the central counterparty. This comment was noted in the Treasury Response and was agreed. However, no consequent amendment has been made to Regulation 36(1)(a) of the Second Draft. It should be made clear in Regulation 36(1)(a) that this obligation on the central counterparty will only apply where the central counterparty knows the identity of the client of the clearing member.

(b) Additionally sub-regulations (1)(e), (1)(f) and (3)(a), respectively, place an obligation on the central counterparty to ensure that:

(i) a clearing member discloses to its clients whether client collateral is protected on an individual or omnibus basis;

(ii) a clearing member discloses to its clients any constraints such as legal or operational constraints , that may impair its ability to segregate or port the clients positions and related collateral; and

(iii) clearing members offer their clients, at least the choice between omnibus client segregation and individual client segregation and inform them of the costs and level of protection associated with each option.

Whilst existing regulatory frameworks make it a requirement for central counterparties to be able to offer the omnibus client segregation and individual client segregation models, the obligation is on the clearing member to offer this to the clearing clients with whom they have the relationship. It would be very difficult for a central counterparty to monitor and enforce this obligation which is placed on the clearing members and this has been recognised under these existing regulatory frameworks. Accordingly we request that the obligations on the central counterparty in sub-regulations (1)(e), (1)(f) and (3)(a) are removed.

2.5 **Regulation 37.2 – Margin System**

In sub-regulation (2)(g) there is a requirement for the margin model to be reviewed at least annually by an independent third party. Under EMIR and other regulatory frameworks the margin model must be reviewed annually and after material changes by an independent party. There is no requirement for this party to be a third party as long as there is independence. As such we would prefer the requirement for the independent party to be a third party to be removed.

2.6 **Regulation 38 – Default Procedures**

Sub-regulation (1)(f) requires the procedure to be set out in the event that a default by the clearing member is not declared by the central counterparty. We would be grateful if you can provide clarity on what sort of events these procedures are intended to cover and the types of procedure which are envisioned here.

2.7 **Regulation 42 – collateral requirements**

In our comments in the First Submission on Regulation 54 (*Collateral Requirements*) of the First Draft, we recommended that the types of securities and currencies which would be acceptable collateral are not specifically defined, but that criteria are specified in a similar way to the EMIR

Technical Standards. We note that whilst our comment has been acknowledged in the Treasury Response, this has not resulted in a consequent amendment in Regulation 42 of the Second Draft. As such, we recommend that in Regulation 42(2) of the Second Draft it is made clear that whilst a central counterparty may accept the instruments listed as collateral, a central counterparty is not restricted to only accepting those assets which are listed therein.

2.8 **Regulation 42.3 – Re-use of collateral collected as initial margin**

In our comments in the First Submission on Regulation 54.3 (*Re-use of collateral collected as initial margin*) of the First Draft we suggested that it is made clear that this regulation does not apply to cash collateral but only to securities provided as collateral. Our comment was noted in the Treasury Response and amended wording was referred to. However, it is not clear from Regulation 42.3 of the Second Draft that the re-use provision only refers to collateral securities. We suggest that cash is specifically carved out from Regulation 42.3 on the basis that in terms of the South African common law a transfer of cash results in a transfer of ownership of such cash and accordingly no consent should be required of the client.

2.9 **Regulation 44.5 – Stress Testing**

Sub-regulations (3)(e) to (h) requires that central counterparties must ensure:

(a) that stress testing (and back testing) results and analysis are made available to all clearing members and when known to the central counterparty, clients;

(b) that for all other clients (i,e. those not known to the central counterparty) the stress testing results and analysis must be made available by the clearing members;

(c) information is aggregated and does not breach confidentiality;

(d) that clearing members and clients only have access to detailed results and analysis for their own portfolio's.

In terms of many existing regulatory frameworks there is only a requirement to provide a high level summary of stress test results and the corrective actions taken. As such it is important that this requirement is retained for foreign central counterparties to ensure consistent regulation of foreign central counterparties. In particular and in respect of sub-regulation (3)(e) we request that it is made clear that the disclosure obligation where the clients are not known to the central counterparty is on the clearing member and no obligation is on the central counterparty to enforce this obligation.

2.10 **Regulation 46.2 – Transaction Records**

In terms of sub-regulation (2) in relation to every transaction received for clearing a central counterparty must immediately upon receiving the relevant information, make and keep updated a record of the following details:

(a) the date and time of settlement or of buy-in of the transaction and to the extent they are available, of the following details:

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(i) the day and the time at which the contract was originally concluded.

Under EMIR it is accepted that the time when a contract is concluded is the time when the trade is cleared. Please confirm this understanding.

3. We trust that our comments will assist you when considering the Second Draft. Should you have any queries in relation to our comments, please do not hesitate to contact Valentina Cirigliano at Valentina.Cirigliano@lchclearnet.com or Corentine Poilvet-Clediere at Corentine.Poilvet-Clediere@lchclearnet.com.

Yours faithfully,

Valentina Cirigliano
Regulatory Strategy Manager

cc: Corentine Poilvet-Clediere
Head of Post Trade Regulatory Strategy