

**NOTICE OF 2016**  
**FINANCIAL SERVICES BOARD**  
**FINANCIAL MARKETS ACT 19 OF 2012**

**CODE OF CONDUCT FOR AUTHORISED OVER-THE-COUNTER DERIVATIVE  
PROVIDERS**

Under section 6(8)(b), read with sections 74 and 75, of the Financial Markets Act, 2012 (Act No. 19 of 2012), I, Dube Phineas Tshidi, Registrar of Securities Services hereby prescribe the Code of Conduct for authorised over-the-counter derivative providers as set out in the Schedule.

**D P TSHIDI**

**REGISTRAR OF SECURITIES SERVICES**

## SCHEDULE

### 1. Definitions and interpretation

(1) In this Schedule, “**the Act**” means the Financial Markets Act, 2012 (Act No.19 of 2012), and “**the Regulations**” means the Regulations prescribed under section 5(1) (b) of the Act, and any word or expression to which a meaning has been assigned in the Act or in the Regulations, bears the meaning so assigned to it.

(2) For the purposes of this code of conduct, the term “**provider**” has the same meaning as “**authorised OTC derivative provider**”.

### 2. Application of the code of conduct

This code of conduct is binding on providers, their officers and employees, clients and counterparties.

### 3. General principles of the code of conduct

A provider must –

- (a) at all times act honestly, fairly, with due skill, care and diligence, and in the interests of clients and counterparties and the integrity of the financial markets;
- (b) communicate information to clients and counterparties in a way which is clear, fair and not misleading;
- (c) at all times manage conflicts of interest fairly, both between itself and its clients and counterparties ;
- (d) observe proper standards of market conduct;
- (e) conduct itself in such a manner that does not impede the objects of the Act;
- (f) maintain knowledge of and comply with all applicable laws, rules and regulations governing its activities;
- (g) engage with the registrar in an open and cooperative way, and must disclose to the registrar appropriately any material incidence of non-compliance with the Act or material operational failure relating to the provider.

#### **4. Categorisation of clients and counterparties**

(1) A provider must establish, maintain and implement written policies and procedures reasonably designed to meet the requirements provided for in subparagraphs (2) to (4).

(2) A provider must, prior to entering into an OTC derivatives transaction with a person, and with regard to existing clients or counterparties-

- (a) determine whether that person is a counterparty as defined;
- (b) in writing notify the person of -
  - (i) its categorisation as a counterparty and the basis of such categorisation;
  - (ii) the limitations to the level of client protection a categorisation as a counterparty entails;
- (c) obtain written confirmation from such person that the person is aware of the categorisation as a counterparty and the effect thereof and that the person agrees with the basis of such categorisation.

(3) Where a client, other than a natural person, pension fund organisation as defined in section (1)(1) of the Pension Funds Act, 1956 (Act No. 24 of 1956), a friendly society referred to in the Friendly Societies Act, 1956 (Act No. 25 of 1956), a medical scheme or the board of trustees of such scheme as defined in section 1(1) of the Medical Schemes Act, 1998 (Act No. 131 of 1998) elects to be categorised as a counterparty, the provider must determine whether it is appropriate for the client to be categorised as a counterparty, as provided for in section 6.

(4) If the provider determines that it is appropriate for the client to be categorised as a counterparty, the provider must warn the client in writing of the limitations to the level of client protection a categorisation as a counterparty entails and the clearing obligations that the client may be subject to.

(5) A provider must, when it becomes aware that a counterparty no longer meets the requirements for a categorisation as a counterparty, take the appropriate action to re-categorise such person as a client and to inform the person accordingly.

(6) A provider must, prior to executing OTC derivatives transactions for the first time with a client that has elected to be categorised as a counterparty, request the client to provide information regarding its knowledge and experience in financial markets and specifically in respect of OTC derivatives, to enable the provider to determine whether it is appropriate for the client to be categorised as a counterparty.

(7) If a provider determines, on the basis of the information provided by the client that has elected to be categorised as a counterparty, that it would not be appropriate for the client to be categorised as a counterparty, the provider must inform the client in writing.

## **5. Appropriateness**

(1) A provider must establish, maintain and implement written policies and procedures reasonably designed to meet the standards provided for in subparagraphs (2) to (10).

(2) A provider must, prior to executing an OTC derivatives transaction with a client, request the client to provide information regarding the client's knowledge and experience in financial markets and specifically in respect of OTC derivatives, to enable the provider to assess whether an OTC derivative transaction in a specific product type is appropriate for that client.

(3) A provider is not required to make an assessment on each occasion of a separate transaction in a specific product type, provided that the provider has made an assessment of appropriateness in respect of that product type.

(4) A provider may rely on the information provided by a client, unless the provider is aware or should reasonably have been aware that the information is manifestly out of date, inaccurate or incomplete.

(5) If a provider determines, on the basis of the information provided by the client, that transactions in OTC derivatives are not appropriate for that client, the provider must inform the client in writing.

(6) If a client elects not to provide the information to enable the provider to assess appropriateness, or if the client provides insufficient information regarding its knowledge and experience, the provider must warn the client, in writing, that the provider is unable to determine whether transactions in OTC derivatives are appropriate for that client.

(7) If a client, despite the warnings by a provider as provided for in subparagraphs (5) and (6), elects to execute a transaction or transactions in OTC derivatives, the provider may continue with such transaction or transactions.

(8) The provision of warnings required in subparagraphs (5) and (6) does not constitute the provision of advice as contemplated in the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002).

(9) The warnings required in paragraphs (5) and (6) may be provided in a standardised format.

## 6. Disclosure to clients

(1) A provider must ensure that representations and information provided to a client are -

- (a) factually correct;
- (b) provided in plain language, avoid uncertainty or confusion and not be misleading, provided that for purposes of this Notice, a disclosure is in plain language if it is reasonable to conclude that a person of the class of persons for whom the disclosure is intended, with average literacy skills and experience in dealing with derivative transactions, could be expected to understand the content, significance and import of the disclosure without undue effort;
- (c) adequate and appropriate in the circumstances of the particular transaction or service, taking into account the factually established or reasonably assumed level of knowledge of the client;
- (d) provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction;
- (e) if provided in writing or by means of standard forms, be in a clear and readable print size, spacing and format;
- (f) as regards all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein, be reflected in specific monetary terms: provided that where any such amount, sum, value, charge, fee, remuneration or monetary obligation is not reasonably pre-determinable, its basis of calculation must be adequately described; and
- (g) where there is a material or significant change affecting a client, or the relevant transaction or service renders it necessary, in which case a disclosure of the changes to the client must be made without delay.

(2) Representations and information may be provided orally and must, if the client so requests, be confirmed in writing within a reasonable time after such request.

(3) Where there is a material or significant change affecting a client in the representations or information previously provided to such a client, or the relevant transaction or service renders it necessary, the provider must disclose the changes to the client without delay.

(4) A provider must provide a general explanation of the nature and material terms, including any restrictions or conditions, and risks of a relevant transaction to a client so as to enable the client to make an informed decision regarding the transaction.

## 7. Client and counterparty agreements

(1) A provider must enter into an agreement in writing with a client or a counterparty conforming to the requirements set out in subparagraph (2).

(2) The agreement must include all terms governing the trading relationship between the provider and the client or counterparty including terms addressing,–

- (a) payment obligations;
- (b) netting of payments;
- (c) events of default or other termination events;
- (d) calculation and netting of obligations upon termination, transfer of rights and obligations;
- (e) the governing law;
- (f) valuation of transactions, collateral and portfolios; and
- (g) dispute resolution.

(3) Despite the minimum requirements provided for in sub-paragraph (2) the agreement must make provision for –

- (a) confirmation of OTC derivative transactions in terms of paragraph 8;
- (b) credit support arrangements, which must contain, the following:
  - (i) initial and variation margin requirements, if any;
  - (ii) types of assets that may be used as collateral or margin and collateral valuation haircuts, if any;
  - (iii) investment and re-hypothecation terms for securities used as collateral or margin for non-cleared OTC derivative transactions, if any;
- (c) the arrangements for safeguarding margin or collateral funds and securities;
- (d) an attestation that the client meets the requirements to be categorised as a counterparty, where applicable;
- (e) the requirement for notification by the counterparty if it ceases to meet the requirements to be categorised as a counterparty;
- (f) consent by the client or counterparty for the provider to report its transactions with its client or counterparty to a licensed or recognised trade repository; and
- (g) the process for determining the value of each OTC derivatives transaction at any time from execution to the termination, maturity, or expiration of such transaction, including

whether the valuation OTC derivative transaction will be based on market value, the provider's internal model or provided by independent third parties, or other objective criteria.

(4) In order to comply with subparagraph (2)(f), a provider is not required to disclose to the client or counterparty confidential, proprietary information about any model it may use to value an OTC derivative transaction.

(5) A provider must maintain a record of all agreements and must make them available promptly upon request to the registrar.

## **8. Timely confirmations**

(1) A provider must establish, maintain and implement written policies and procedures reasonably designed to meet the standards provided for in sub-paragraphs (2) to (7).

(2) A provider must use best efforts in accordance with market practice per product type to ensure that the transactions are confirmed–

(a) by the end of the business day following the day of conclusion of the OTC derivative transaction, per product class, counterparty and client as set out in Annexure A; and

(b) in respect of complex products, five business days following the day of the conclusion of the transaction.

(3) Where an OTC derivative transaction is concluded after 16.00 local time, or with a counterparty or client located in a different time zone which does not allow confirmation by timelines provided for in Annexure A, a provider must ensure that the confirmation is executed one business day following the timelines prescribed in Annexure A.

(4) The provisions of this paragraph do not apply to OTC derivative transactions governed by a master agreement where a transaction supplement, which includes the valuation, margin or collateral call, is sent to a counterparty or client by 14.00 on the first business day following the day the OTC derivative transaction was concluded and daily thereafter for as long as the OTC derivative transaction remains open.

(5) The provisions of this paragraph do not apply to cleared OTC derivative transactions, however if an OTC derivative transaction has not been accepted for clearing by a clearing house, the provider must ensure the execution of the confirmation, as provided for in this Notice.

(6) A provider must make and retain a record of –

(a) the date and time of transmission to a counterparty or client of any transaction supplement; and

(b) the date and time of transmission to a provider or receipt from a counterparty or client of any confirmation.

(7) A provider must provide the registrar with a monthly report, within 10 business days of the previous calendar month end which sets out, per product type and client or counterparty, the number OTC transactions not confirmed within the timelines set out in Annex A.

## **9. Portfolio reconciliation**

(1) In order to identify at an early stage, any discrepancy in a material term of a non-cleared open OTC derivative transaction, including its valuation, a provider must establish, maintain and implement written policies and procedures reasonably designed to enable it to perform a portfolio reconciliation –

(a) with a counterparty –

- (i) daily, where the portfolio consists of 500 or more open OTC derivative transactions;
- (ii) weekly, where the portfolio consists of between 51 and 499 open OTC derivative transactions on any business day during any week; or
- (iii) quarterly, where the portfolio consists of between 1 and 50 open OTC derivative transactions at any time during a calendar quarter;

(b) with a client –

- (i) quarterly, where the portfolio consists of 101 or more open OTC derivative transactions; or
- (ii) annually, where the portfolio consists of between 1 and 100 open OTC derivative transactions.

(2) The provisions of sub-paragraph (1) do not apply to OTC derivative transactions governed by a master agreement where a transaction supplement, which includes the valuation, margin or collateral call, is sent to a counterparty or client by 14.00 on the first business day following the day the OTC derivative transaction was concluded and daily thereafter for as long as the OTC derivative transaction remains open.

(3) The portfolio reconciliation may be performed on a bilateral basis by the provider and its counterparty or client, or by a third party duly mandated to this effect by the counterparty or client.

(4) The policy and procedures, referred to in subparagraph (1), must provide for–

- (a) the resolution of any discrepancy in a material term of an OTC derivative transaction identified as part of a portfolio reconciliation or otherwise, as soon as possible, but in any event within three business days;
- (b) the resolution of any discrepancy in a valuation identified as part of a portfolio reconciliation or otherwise as soon as possible, but in any event within five business days;
- (c) the deeming as a dispute, of-
  - (i) a discrepancy in a material term of an OTC derivative transaction not resolved within three business days; and
  - (ii) a discrepancy in a valuation not resolved within five business days.

## **10. Dispute resolution**

(1) A provider must establish, maintain and implement written policies and procedures reasonably designed to ensure -

- (a) the identification, recording, and monitoring of disputes relating to –
  - (i) the material terms of an OTC derivative transaction; and
  - (ii) the recognition or valuation of the OTC derivative transaction and the exchange of collateral between the provider and its counterparty or client;
- (b) the recording of the length of time for which the dispute remains outstanding, the counterparty or client and the amount which is disputed;
- (c) the resolution of disputes in a timely manner with a specific process for those disputes that are not resolved within five business days.

(2) A provider must promptly notify the registrar of any disputes relating to an OTC derivative transaction, its valuation or the exchange of collateral for an amount or a value higher than R100 million and not resolved within in 10 business days.

## **11. Portfolio compression**

(1) In order to reduce its counterparty credit risk, a provider must establish, maintain and implement written policies and procedures reasonably designed to ensure that it, –

- (a) regularly, but at least twice a year, analyses the possibility of conducting a bilateral or multilateral portfolio compression exercise, where appropriate and technologically

possible, in respect of non-cleared open OTC derivative transactions with other providers; and

(b) terminates fully offsetting non-cleared open OTC derivative transactions with its counterparties and clients.

(2) A provider must ensure that it is able to provide a reasonable and valid explanation to the registrar for concluding that a portfolio compression exercise is not appropriate.

(3) A provider must make and maintain a complete and accurate record of each bilateral offset and each bilateral or multilateral portfolio compression exercise in which it participates.

## **12. Safeguarding of collateral and margin**

(1) A provider who receives or holds any funds or securities of a client or counterparty as collateral or margin, must, with regard to such funds and securities, observe utmost good faith, exercise proper care and diligence and deal therewith in the best interests of the client or counterparty.

(2) A provider-

(a) must open and maintain a separate account designated for clients' and counterparty's funds at a bank;

(b) must within one business day of receipt pay into the account all funds held on behalf of clients or counterparties;

(c) must ensure that the separate account only contains funds of clients and counterparties and not those of the provider;

(d) may not cause securities to be registered otherwise than in accordance with the instructions given to the provider, in the absence of such instructions, the provider may not cause financial products to be registered otherwise than in the name of-

(i) the client or counterparty; or

(ii) a nominee.

## **13. Arrangements with an intermediary**

Where a provider enters in an arrangement with an intermediary in terms of which the intermediary markets and sells OTC derivatives to clients on behalf of the provider, the provider must ensure that the intermediary –

- (a) is authorised appropriately as a financial services provider in terms of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002);
- (b) discloses to the client, in writing, the nature of the arrangement and the relationship between the provider and the intermediary, including any fees that will be charged by the intermediary;
- (c) performs the disclosure requirements, as provided for in paragraph 6, on behalf of the provider;
- (d) performs the appropriateness test requirements, as provided for in paragraph 5.

#### **14. Advertising or solicitation**

A statement, advertisement, brochure or similar communication by a provider that relates to the business of a provider or an OTC derivative must be fair, clear, correct, not misleading or contrary to the public interest.

#### **15. Confidentiality and privacy**

A provider may not disclose any information acquired or obtained from a counterparty or client, except-

- (a) the person to whom the confidential information relates has given consent;
- (b) disclosure is required or permitted in terms of a law or a court order;
- (c) disclosure is necessary to carry out his, her or its functions or in the course of performing duties under any law; or
- (d) disclosure is required for the purposes of legal proceedings.

#### **16. Policies and procedures**

The policies and procedures referred to in this Notice must be approved, in writing, by senior management of the provider.

#### **17. Waiver of rights**

A provider may not request or induce in any manner a client or counterparty to waive any right or benefit conferred on the client or counterparty by or in terms of this code of conduct, or recognise, accept or act on any such waiver by the client or counterparty, and any such waiver is void.

## **18. Legal certainty**

Non-compliance with the provisions of this code of conduct will not -

- (a) affect the validity of an OTC derivative contractor the possibility for the parties to enforce the provisions of an OTC derivative contract; or
- (b) give rise to any right to compensation from a party to an OTC derivative contract.

## **19. Transitional arrangement and commencement date**

(1) A provider must comply with the provisions of this Notice within six months of its authorisation.

(2) This Notice comes into operation on the same date on which the Regulations come into operation.

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## Annex A

### Acknowledgement schedule

<b>Product Class</b>	<b>Counterparty</b>	<b>Client</b>
Interest Rates	business day	first business day
Credit	business day	first business day
Foreign Exchange	first business day	second business day
Equities	first business day	second business day
Commodities	first business day	second business day

### Confirmation schedule

<b>Product Class</b>	<b>Counterparty</b>	<b>Client</b>
Interest Rates	first business day	second business day
Credit	first business day	second business day
Foreign Exchange	first business day	second business day
Equities	first business day	second business day
Commodities	first business day	second business day