
Guidelines on the Investment of Funds SAFEX CLEARING COMPANY (Pty) Ltd



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1. BACKGROUND TO THIS DOCUMENT

At present all funds managed by Safcom are invested in a variety of accounts spread across all F1+ or F1 banks, for terms between call and 90 days with an average not exceeding 40 days

2. INVESTMENT GUIDELINES.

2.1 BACKGROUND TO SAFEX CLEARING COMPANY (PTY) LTD

Equity derivatives, Commodity derivatives, Currency derivatives and Interest Rate derivatives products members transact on the market on behalf of themselves and their clients. In order to transact, all participants are required to place an initial margin “deposit” with their members. These sums are paid daily via clearing members to Safcom, which in turn deposits these funds with various financial institutions. All these funds are administered and managed by Safcom. All interest earned on funds deposited with the institutions, less Safcom’s administration fee of 20 bps for Equity derivatives and Commodity derivatives and 12,5bps in the case of Currency derivatives and Interest Rate derivatives to the clearing members for onward payment to their members and in turn to clients.

2.2 PHILOSOPHY

The management of these funds implies a fiduciary duty to the clearing members, members and their respective clients. Consequently, the utmost care must be taken as to where and how these funds are managed. The ultimate aim for the management of these funds is therefore to **“maximize the investment income earned on funds invested whilst minimizing the inherent risks related thereto.”**

2.3 RISKS

The primary risks relating to these funds are: -

Credit Risk, or the risk of default by the recipient institution, & Liquidity Risk or the risk that the funds invested cannot be timeously withdrawn.

CREDIT RISK:

No counterparty is exempt from the process of having a credit limit imposed. Strict limits will be imposed on all approved counterparties. As the management of credit risk and counterparty limits is a dynamic process these limits must be reviewed on at least an annual basis. Only banks that have been accredited with a formal rating by one of the reliable rating agencies will be considered.

LIQUIDITY RISK:

The funds managed by SAFCOM are invested on behalf of the members' clients. These funds must be available for withdrawal as and when required as a result of a change in positions. The total funds invested can be divided into a "volatile portion" and a "core portion" of funds. The core portion tends to be fully and continually invested whilst the volatile portion tends to fluctuate.

2.3.1 CREDIT RISK

The Risk that claims on others may not be receivable on due date or at their full book value.

As Credit Risk plays such a vital role in this Fund, the minimum requirement will be a F1+ or F1 (or agency equivalent) rating. Should any of the existing counterparties be either placed on a ratings watch list or be downgraded, their limits must be immediately re-examined and adjusted accordingly. This is of the utmost importance. The JSE currently subscribes to a recognized credit agency and therefore will rely on their ratings in order to assess and compute credit limits.

LIMITS:

If an individual bank is part of a group of banks then the limits applied are for the banking group as a whole.

There is no differentiation between local and foreign banks as it is considered that they have similar risks.

- LOCAL BANKS AND BRANCHES OF FOREIGN BANKS:

F1+Banks: up to a maximum of 20% of fund size.

F1 Banks: up to a maximum of 15% of fund size.

- SUBSIDIARIES OF FOREIGN BANKS:

F1+Banks: up to a maximum of 10% of fund size.

F1 Banks: up to a maximum of 10% of fund size.

BANK	RATING		LIMIT			
ABSA Bank	F1+		20% of fund size – ABSA Bank & ABSA Money Market Fund must be treated as one institution			
ABSA Money Market Fund	F1		15% of fund size – ABSA Money Market Fund & ABSA Bank must be treated as one institution			
FIRSTRAND	F1+		20% of fund size			
INVESTEC	F1		15% of fund size			
NEDBANK LIMITED	F1+		20% of fund size			
STANDARD BANK	F1+		20% of fund size – Standard Bank & Stanlib Corporate Money Market Fund must be treated as one institution			
STANLIB CORPORATE MONEY MARKET FUND	F1		15% of fund size – Stanlib Corporate Money Market Fund and Standard Bank must be treated as one institution			
CITIBANK NA SOUTH AFRICA	F1	"Foreign" Branch	15% of fund size			
DEUTSHE BANK	F1+	"Foreign" Branch	20% of fund size			
JPMORGAN CHASE	F1	"Foreign" Branch	15% of fund size			
STANDARD CHARTERED	F1	"Foreign" Branch	15% of fund size			
Societe Generale (Socgen)	F1+	"Foreign" Branch	20% of fund size			
SA GOVT*			Maximum of 35% of fund size			
SARB**			Maximum of 35% of fund size			

*Instruments with a maximum tenor of 91 days

** Instruments with a maximum tenor of 91 days

***Agencies Rating Definitions:

Fitch

Short Term F1+ or F1

NOTE: There differentiation between foreign branches and subsidiaries of foreign banks is because a branch would not be allowed to fail as it is covered by its holding company. There are no guarantees on the same basis for a subsidiary, although the chances of that happening may be small.

2.3.2 LIQUIDITY RISKS

The Risk that claims by others may not be repayable timeously.

Safcom's investment managers must ensure that there is sufficient liquidity to meet the needs of its clients. For example, if the size of the total fund is R16bn then an amount of approximately 30% must be invested on call at all times. There is no maximum limit on the amount of funds that can be invested in this way. The remaining funds i.e. amounts not invested on call can be invested for any period with a maximum tenor of 91 days. The overall weighted average duration of the investments may not exceed 40 days.

Example Calculation of Weighted Average Duration:

Total fund size	R16 bn
Amount invested on call	30% R 4,8 bn
Amount invested for 90 days	70% R11,2 bn
Weighted Average Duration	$((4,8 * 1) + (11,2 * 90))/16$ = 63,3 days NOT COMPLIANT!!

Total fund size	R16 bn
Amount invested on call	25% R4,000 bn
Amount invested for 30 days	35% R5,600 bn
Amount invested for 60 days	25% R4,000 bn
Amount invested for 90 days	15% R2,400 bn
Weighted Average Duration	$((4,0 * 1)+(5,6 * 30)+(4,0 * 60)+(2,4 * 90))/16$ =39,25 days COMPLIANT

The calculation of the Average Weighted Duration must be computed on a daily basis.

2.4 CALCULATION OF INTEREST

The Safex overnight rate is the average actual deposit rate earned on the Safcom funds deposited. This rate is used by the market as the **benchmark** rate for a number of products.

The reason that it is a trusted rate is because it is a "**real**" rate – based on *actual* funds on deposit on an overnight basis. If some of these funds can now be deposited on a term basis, the rate achieved, whilst convertible back to a daily or overnight rate, is not in fact an *overnight rate*. This will distort the rate as published and extensively utilised. In other words it is *no longer a true and real overnight rate, but rather a composite overnight and term rate of deposit*. A large portion of the funds will continue to remain on overnight call. Therefore, there will still be a valid "real" overnight rate against which will still act as an overnight interest rate benchmark. Furthermore, it is suggested that a *second* rate also be published – an "**interest on margin rate**". This would be a blended rate of return of all the funds invested – call and term (less the

20/12.5bps charged by Safcom. It could differ from the overnight rate depending on how the funds have been invested.

Interest is calculated and payable on a monthly basis. The rate of interest payable to the clients of Safcom will be the average rate of interest earned by Safcom for the month less an administration fee of 20/12.5 bps. Rates will be calculated correct to 2 decimal percentage points.

2.5 ELIGIBLE INVESTMENT INSTRUMENTS

The following investment instruments may be used:

- Overnight call
- Call bonds
- Fixed deposits (only with interest payable on a monthly basis)*
- Negotiable Certificates of Deposit*
- Treasury Bills*
- SARB Debentures*
- Repurchase Agreements &/or Carries*

* May not have a tenor or time to maturity in excess of 91 days

3 CONCLUSION

The returns from investing according to the guidelines are passed onto Safcom's member clients for onward payment to their clients. Safcom publish 2 rates of interest earned – an “overnight rate” as well as an “interest on margin rate”, there is thus no disruption to the market and the users of these rates.

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