national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

RESPONSE DOCUMENT

TREASURY RESPONSE ON ISSUES RAISED OVER THE CONSULTATION PROCESS

TO INFORM THE REVISED FINANCIAL MARKETS BILL

3 AUGUST 2012

national treasury
Department: National Treasury
REPUBLIC OF SOUTH AFRICA

FSB

TABLE OF CONTENTS

1. BACKGROUND

INTRODUCTION

After taking into consideration the comments submitted in response to the Financial Markets Bill released in May 2012, comments were reviewed by a working group composed of representatives of the National Treasury and Financial Services Board. To better understand the technical aspects, representation from JSE Limited and Strate Limited, in their regulatory capacity, was roped in where it was felt that it is appropriate to do so.

Comments were received from market participants representing various sectors and industry associations within the financial markets, including banks, law firms and asset managers. The respondents made inputs on a number of major themes in the Bill; and provided detailed drafting proposals for particular clauses. In the review process, the working group has incorporated suggestions and responded to requests for clarification made by commenters.

This document is the culmination of that process and informs National Treasury's response to the comments received. National Treasury believes that the consultative nature to its approach to designing the regulatory framework has effectively addressed commenters' concerns, while maintaining a level of flexibility to accommodate innovation in financial markets as South Africa and the rest of the world prepare to usher in extensive reforms.

National Treasury would like to thank the Standing Committee on Finance for the opportunity to formally respond to comments, and present the regulatory proposals in the revised Financial Markets Bill.

2. COMMENTS AND TREASURY RESPONSES

A number of respondents (15 in total representing various sectors and industry associations within the financial markets) commented on the Financial Markets Bill that was released for Parliament in May. While every effort has been made by the working group to address these concerns, there have been relatively few substantive changes from the original Bill - most changes are intended to give better effect to principles contemplated in the Bill.

It should also be noted that there are numerous wording/grammatical amendments that have been effected. To that end, much of the document highlights the main issues raised by stakeholders and makes proposals to address particular concerns.

CHAPTER I: PRELIMINARY PROVISIONS

Definitions and interpretations

Following from the comments received from stakeholders and as well as extensive internal discussions, it was proposed that several definitions be amended and/or deleted. These changes have not only complemented, but also give better clarity to the principles and interpretation of the Act.

‘‘prescribed by the Minister’’

The definition of "*prescribed by the Minister*" needs to be expanded to be consistent with the definition of "*prescribed by the registrar*", and with other legislation such as the Banks Act. Stakeholders highlighted that the provisions for regulation to be made under Section109 are devoid of the obligation for the Minister to publish the regulations in the Gazette.

National Treasury response: Agreed, and changes were made as per as the submission. The Minister is required to publish regulations in the Gazette.

"central securities account"

The comment came through that the definition of "*central securities account*" as it refers to "*(c) any other persons as determined in the depository rules*" is too wide and allows the CSD to compete with participants.

National Treasury response: The Treasury disagrees with this interpretation. The definition is talking to "what is" a central securities account, and not to "whom" it relates to, as implied by the comment. It is proposed that the definition be left as is.

"derivative instrument"

The definition of "*derivative instrument*" had previously been retained from the SSA. Further, derivative instrument is included in the list of securities included in the definition of security. The comment came that internationally a simple concept of a derivative is extremely difficult to define. Even for the purposes of the FMB, an instrument based on an index is also a derivative instrument. It was proposed that the May definition is too broad and would capture non-derivative type products, like home loans. A suggestion was therefore made to align the definition to that in the CPSS-IOSCO principles for Financial Market Infrastructures.

National Treasury response: The Treasury agrees that the definition was overly broad and would have unintended consequences of capturing non-derivative type products. Thus in order to align the definition of derivatives to international standards, the definition given in the CPSS-IOSCO document[1] has been incorporated, save for the wording "*default event*" instead of "*factual events*" as this could include wages in the definition.

"juristic person"

The term *"juristic person"* is not defined in the Bill. However if the meaning in the Bill aligns with the meaning contemplated in the Companies Act, then it is not clear whether the meaning includes as association or a partnership. Partnerships are generally not included in the ambit of "*juristic person*" and in South African law only certain associations are juristic persons. For the sake of clarity, the term "*juristic person*" should be defined in the Bill. It is further noted that if the intention was to exclude associations then [certain clauses] may be redundant and if the intention was to include associations and partnerships, the provisions of section66 and 68 should be expanded to contemplate associations and partnerships.

National Treasury response: Agreed, and the recommended wording has been incorporated

[1]"Principles for Financial Market Infrastructure", CPSS-IOSCO, April 2012

"nominee"

Concern was raised regarding the amendment of the definition of *"nominee"* from the previous SSA definition, as this causes a shift from previously including both regulated and unregulated nominees, to include only regulated nominees. This will mean that informal arrangements will no longer be allowed, unless such person is approved in terms of section78. Further, the view is that the use of the term in the Companies Act does not envisage the concept of an approved nominee only, for example the issuing of shares under section 41, especially in the instance of small unlisted companies.

National Treasury response: To ensure that only approved nominees are allowed the approval in terms of section 76 was included. The reference to "*registered* holder" is not aligned with holding under the Companies Act and was accordingly deleted. So as to not include the informal arrangements referred to above, consequential amendments were effected to the definition of nominee under the Companies Act.

"securities"

Including *money market* instruments in the definition of securities would have unintended consequences. Banks trade and make markets in money market securities, and by definition these activities would be captured under the Act. This would potentially trigger the exchange definition for banks, requiring each bank to apply for an exchange license. The suggestion was made to rather give discretion to the registrar to apply certain provisions of the act to defined categories of money market instruments where necessary, for example with respect to the CSD section which must deal with dematerialised money market securities that come into the depository environment.

National Treasury response: It is not intended that banks be required to hold exchange licences in order to trade in the money market, provided that they are not in fact matching buyers and sellers. However while it is not believed that banks perform this role, as are generally a buyer or seller in the transactions, and therefore would not captured under the exchange definition, the consequences of bringing money market instruments fully under the ambit of the Act are not fully understood and could undermine the integrity and liquidity in the money market, bringing systemic risk. Accordingly money market instruments have been excluded from the definition of securities. However the Registrar may deem an instrument to be a security for the purposes of the Act and may do so of money market instruments following further investigation into this matter.

"securities"

Exclusion of SARB trading in its own shares from the ambit of the FMB

The FMB in its current form also brings the regulation of the trading of the South African Reserve Bank (the Bank) in its own shares within the purview of the Bill and the Registrar of Securities Services. The definition of *"securities"* provides for the inclusion of amongst others, shares, depository receipts and debentures in public companies and other equivalent equities other than shares in a share block company as defined in the Share Blocks Control Act, 1980 (Act No 59 of 1990). By implication the Bank's trading in its own shares falls within the definition of *"securities"* and will therefore be regulated by the FMB, which is not understood to be Treasury's intention. The FMB aims to ensure that the South African financial markets are fair, efficient and transparent. The South African Reserve Bank trades in its own shares for purposes of allowing the South African public an opportunity for participation in some form in the central bank as opposed to participation in a scheme for financial gain. There is therefore no apparent need for regulation with regards to the activity of the SARB trading in its own shares. It cannot therefore be contemplated that the Banks trading on its own shares will be subject to the regulatory regime proposed in the FMB. The reference to "*public companies*" in the current definition of the term "*securities*" should state:

> *"public companies as envisaged in the Companies Act".*

This will exclude the trading activities of the Bank in its own shares. Alternatively the definition of "*securities*" should include paragraph (f) as follows:

> *"(f) the Banks' activities of trading in its own shares by means of an over-the-counter-share-trading-facility (OTCSF) is excluded"*

"securities"

In terms of section1 of the FMB, the definition of *"securities"* in the SSA is amended to:

(1) *include both listed and unlisted instruments; and*

(2) *restrict bonds to those issued by public companies, public state-owned enterprise and the Government of the Republic of South Africa."*

The purpose of the amendment was to clarify that the reference to securities in the FMB includes both listed and unlisted securities, and further seek to correct the reference to money market instruments to refer instead to money market securities, a term which has been defined. This reaffirms the Registrar's proposed ability to regulate unlisted securities in line with IOSCO and G20 recommendations. A problem arises in the amendment sought by the FMB to the Companies Act. The FMB seeks to incorporate the definition of securities into the Companies Act, adding that in the context of the Companies Act, it includes shares in a private company. This may pose a number of problems if one considers that the definition in the first draft of the Companies Act incorporated in the definition in the SSA. This was, however, rejected and the definition in the enacted version of the Companies Act reads *"any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company".* If this proposed amendment to the Companies Act is implemented it means that the offering of participatory interests in a collective investment scheme, which is dealt with in terms of the *Collective Investment Scheme Control Act, 2002*, will then be regulated under the Companies Act, and this is incorrect. Similarly it is inappropriate in the Companies Act to deal with bonds or debentures which are not convertible into equity in the same manner as other types of securities.

National Treasury response: National Treasury agrees with these proposals.

"this Act"

A request was made by the FSB that the definition of "*this Act*" as in the November 2011 version of the Bill is brought back, On reconsideration that this definition is essential for the proper administration of the Bill.

National Treasury response: National Treasury agree with the suggestion but will incorporate the definition as suggested by the Parliamentary legal adviser.

"insolvency proceeding"

The FMB proposes the definition of *"insolvency proceeding".* This definition is identical to the definition in the Rules of Strate Limited (as updated in Government Gazette no.34811 dated 9 December 2011).

The main issue with this definition arises from section1(2)(b) which conflicts with the common law. In terms of our common law, insolvency proceedings are deemed to have commenced on the filing at court of an application for insolvency proceedings. It is conceivable that a time delay could exist between the date of filing and the date on which the Registrar is notified and this may result in uncertainty.

National Treasury response: Agreed. In s31, a new section is inserted to impose a duty on participant to notify the Regulator and the CSD on filing action.

"execution venue"

The licensing requirements of SROs are necessarily rigorous. However, these provide high barriers to entry and may serve to reduce competition in South African financial markets. Other jurisdictions such as the European Union have developed regulatory mechanisms that allow for different types of execution venues that perform more limited functions (e.g. specifically catering for the professional market where settlement is achieved bi-laterally). This approach promotes competition while still safeguarding financial stability. In addition, to meet the G20 commitment it will be necessary to consider electronic trading platforms on which standardised OTC derivatives may be traded. To achieve a similar approach it is proposed that a definition of an "*execution venue*" is inserted in the Bill and provision is made for the Minister to prescribe Regulations regarding the provision of services or the performance of functions in terms of the Act.

In the interests of encouraging competition in the South African financial market and in support of the G20 commitments, it was proposed that provision be made for the inclusion of an "*execution venue*" definition.

National Treasury response: The National Treasury is of the view that this proposal represents a significant policy shift that should be more appropriately considered in the context of the SRO/market structure review process (the process envisaged to begin in the final quarter of 2012). Allowing for a less regulated version of the current exchange model could bring fragmentation into the [relatively small] South African market, and if not adequately ring-fenced could have the unintended consequence of cannibalising the main listed equities and debt markets, undermining their liquidity, growth and development.

Other amendments

"Market infrastructure" (new definition/insertion)

Recognising the need to separate the market infrastructure function from the regulatory functions of a self-regulatory organisation (SRO), and as a precursor to the SRO review process, a new definition of *market infrastructure* has been added to the Bill:

> *"**market infrastructure**" means each of the following*
> *a licensed central securities depository;*
> *a licensed clearing house;*
> *a licensed exchange;*
> *a licensed trade repository;"*

The legislation should be clear that an exchange/clearing house/CSD etc is licensed primarily because of its activity i.e. trading/clearing/settlement, and not because it is an SRO. Instead it is because of the licence obligations that these entities have supervisory and regulatory responsibilities and therefore are SROs by implication. The term market infrastructure better captures this concept. It also makes more sense to speak of market infrastructure generally as while all SROs are market infrastructure, not all market infrastructure are SROs (namely an associated clearing house and trade repository). Going forward it is expected that more flexibility regarding the regulatory function should be accommodated, but this will take place as part of the SRO review to dovetail the twin peaks reform.

"Self-regulatory organisation" (deletion)

The introduction of market infrastructure also represents a shift in the structure of the Bill. While the definition of *self-regulatory organisation* has been done away with, the principles have been retained as a function of the license. The separation of the commercial from the regulatory functions of a market infrastructure does not preclude certain market infrastructure being required to perform regulatory functions. The concept of a market infrastructure is further intended to give flexibility to the concept of market infrastructure not necessarily being SROs. As indicated above, the SRO model will be formally dealt with as part of the SRO review process for upcoming regulation

"Inter-dealer Brokers" (new definition/insertion)

Inter-dealer brokers are key players in the secondary government and corporate bond markets and trade exclusively between other members of the JSE (particularly the market makers and their subset the primary dealers). Inter-dealer brokers provide vital services to the market, including (but not limited to) consolidating and providing information about competing quotations on the prices and quantities at which other dealers are willing to transact, and encouraging trade activity and efficient price discovery. There are two categories of inter-dealer brokers authorised to trade and to provide services in respect of the buying and selling of securities - *Matched-principal* and *Name-give up.* Currently inter-dealer brokers are a sub-category of trading member (but not clearing member) of the JSE. However, despite the significant role inter-dealer brokers play in the market, these entities operate markets similar to the licensed exchange and yet are not regulated in the same way as a licensed exchange. Regulation does not go beyond the reporting requirements prescribed by the JSE and this opens up disparities that affect investor protection and the operation of the market as a whole. After extensive internal discussions, it was therefore proposed that the regulation of inter-dealer brokers needs to be extended to capture their role and the proposal is to define the inter-dealer broker in recognising the special role it plays in the market. Further, a distinction needs to be made between what an exchange does vs. the services an IDB provides, given the current definition of *exchange.* To address disparities, the legislation has gone further to facilitate the significance of the finality of a transaction: whether conclusion is effected through an exchange and therefore such a market player should be regulated as an authorised user of the exchange. Alternatively, where finality rests within the entity itself, then such an entity must be licensed as an exchange and must therefore comply with all the requirements bestowed by regulation on an exchange, including licensing, performing supervisory functions and the like. The intent is to breach the gap where there might be potential for "exchange-lite" entities that perform similar functions to an exchange but with disproportionate regulatory requirements. s16(2)(*ee*) and (*ff*) are enabling clauses to give effect to these proposed changes.

"Regulated person" (amendment)

The definition of *regulated person* has been extended. This extension exerts two effects on the categories of regulated persons: firstly to extend the powers of the Minister (in terms of s5(1)) to include existing unlisted securities. Secondly, to capture into the ambit of the Act those entities that exist outside regulation (in terms of s5(2)) where the Minister has been empowered to declare particular entities that provide securities services (whether in listed or unlisted securities) not currently regulated and where it would further the objects of the Act to regulate such persons, to become regulated. Examples of such entities and role-players are derivative trading platforms that fall outside of the exchange definition, for example where the entity takes economic risk in the transaction. With the inclusion of the words *"…furthering the objects of the Act…"* , the intent is to also capture other players (e.g. Contract For Difference - CFD providers) who are providing securities services that are not subject to regulation in the unlisted security environment. This will ensure that changes in the markets can be adequately addressed.

"external clearing house", "external clearing member", "external exchange", "external participant", "external trade repository" (amendment)

The definitions have been amended to reflect the meaning of a foreign entity that is not be authorised in terms of this Act (by deletion of "*authorised...by this Act")*, but may be authorised by equivalent laws of a country other than the Republic.

Objects of the Act

There is a well-established role for regulators to oversee the conduct of monopolies in order to protect consumers and promote competition. For example, the registrar could be required to conduct a regular review of the fees charged by SROs, as well as other aspects of an SRO's market conduct. In this regard, we support the inclusion of an additional objective in Section2 of the Bill (Objects of the Act) that provides for competition within the South African financial markets. The concern expressed by NT that too much competition can be detrimental to financial stability is addressed by the need to balance the competition objective with the existing objective of reducing systemic risk.

As SROs perform both regulatory functions and commercial activities, the Bill should be clear that both sets of activities are regulated as both require oversight and supervision by the registrar. The rationale for this is:

- the systemic importance of many of the functions performed by an SRO, especially an

exchange;
- the monopolistic structure of financial markets infrastructure in South Africa; and
- the need to ensure proper market, as well as investor and consumer protection.

Insert new sub-section2(d):

"*the promotion of competition in South African financial markets*".

National Treasury response: National Treasury supports the principle of competition provided that it does not undermine systemic stability or investor protection. This principle is already captured in section 2(e) which states that one of the aims of the Act as to "…*promote the competitiveness of the South African financial markets and of securities services in the Republic". In addition the Registrar is required as [art of his or her duties to consider competition. Section 6(3)(v) states that the registrar must have regard to the principle that competition between regulated persons should not be impeded or distorted in performing his functions.

Chapter II: Regulation and Supervision of Financial Markets

Minister, Registrar and Deputy Registrar of securities services

As alluded to earlier, the review process has also introduced structural changes to the revised Bill. While in the previous FMB, section5 referred to the *Minister, Registrar and Deputy Registrar of Securities Services*, and aimed to capture the powers and authority afforded to each. However, in the spirit of good drafting practice the section has been separated to accommodate the *Powers of the Minister* under section5 and new section6 refers to the powers of the *Registrar and Deputy Registrar of Securities Services*. It is thus necessary to incorporate amendments under each relevant clause:

new 5(1) - This provision is not new to the Bill, but taken from the previous version as tabled in May, section77(1). See the explanation relating to unlisted securities for a fuller explanation in this regard.

new 5(2) - A new power is afforded the Minister to capture market players not already explicitly provided for in the Bill. This is necessary to ensure regulatory completeness and minimise regulatory arbitrage, given the continually evolving nature of financial markets, wherein technology is on the one hand bringing in new types of participation and on the other hand is increasingly blurring the roles of existing role-players, making these roles less distinctive.

new 5(3) - This provision is likewise not new to the Bill (section5(6) of the May tabled Bill), but is centralised here under Minister powers.

new 6(3)(o) - Systemic risk - This section recognises the role of the SARB in identifying, monitoring and taking steps to mitigate systemic risk across the financial system, and ensures that the Registrar will coordinate with the SARB on these matters in relation to the financial markets.

new 6(6) - These provisions are not new but taken from section77 of the May Bill. It gives the Registrar powers to make rules relating to unlisted securities, including OTC derivatives, and should be read together with section5(1), so that these rules are consistent with regulation prescribed by the Minister as relating to these instruments.

5(3)(n)

The full term of the definition for "Governor" is used in sub-section5(3)(n). We propose that this sub-sectionbe amended as follows:

> *"(n) must inform the Minister and the Governor* ***[of the Reserve Bank]*** *of any matter that in the opinion of the registrar may pose systemic risk to the financial markets.*

National Treasury response: The proposed amendment has been effected – s6(n)

5(6)

Section5(6) provides that external authorised users, external exchanges, external participants, external central securities depositories, external clearing houses or external clearing members *("external parties")* can only provide services or perform functions in terms of the Act as prescribed by the Minister. To ensure that Bill does not prevent the use of the services of a foreign clearing house that is not designated as an external clearing house, as explained in paragraph 3.2 of our comments, we believe that it is necessary, in the interests of clarity, to provide for the designation of the status of the parties listed in this clause. In addition, in the interests of encouraging competition in the South African financial market and in support of the G-20 commitments, as discussed in paragraph 2.1 in our comments, we propose that provision is made for the inclusion of an *"execution venue"* in this clause.

Consequently, we propose that sub-section5(6) is amended:

> *"(6) An external authorised user, external exchange, external participant, external central securities depository, external clearing house,* ***[or]*** *external clearing member <u>or execution venue, designated as such</u>, may only be provide services or exercise functions in terms of this Act as prescribed by the Minister."*

National Treasury response: While National Treasury appreciates that the markets continue to evolve and innovate, however, it needs to be conscious that this represents a significant and complex shift in the policy direction not contemplated by Bill. Therefore, it would not be possible to know at this stage all the information to which it may be necessary to open the South African markets, and the Treasury is of the view that given the current South African financial markets landscape, such transformations will inform the agenda for processes going forward.

CHAPTER III: EXCHANGES

Requirements applicable for exchange licence and licensed exchange

7(2) (now 8)

Despite the general discretion afforded to the registrar, provided in section 5(3)(m), to exempt any person or category of persons from the provisions of a section of the Act, section7(2) provides the registrar with specific discretion to exempt an applicant and a licensed exchange from the requirements applicable to an applicant and a licensed exchange. It is not clear why it is necessary to afford the registrar this specific discretion and why a similar discretion has not been provided for with regards to the licensing of a clearing house and a central securities depository.

National Treasury response: section 7(2) (now 8) has been deleted

Listing of securities

10(3)

As the *"payment of compensation"* has been deleted from 10(1)(g)(iv) and *"any other penalty"* has been provided for in 10(1)(g)(v), we submit that 10(3) should be amended as follows:

*"(3) if a person fails to pay a fine or **[compensation]**<u>penalty</u> referred to in subsection (1)(g), the exchange may file with the clerk or registrar of any competent court a statement certified by it as correct, stating the amount of the fine imposed or **[compensation]**<u>penalty</u> payable, and such statement thereupon has all the effects of a civil judgement lawfully given in that court against that person in favour of the exchange for a liquid debt in the amount specified in the statement."*

National Treasury response: Agreed. The clauses have adjusted to refer to the "penalty" payable.

16(7)

The placement of a comma implies that this provision is not binding on officers and employees of authorised users and of the exchange

> *"An exchange rule made under this section is binding on the exchange, its authorised users, issuers of securities listed on that exchange and on their officers and employees, and on clients of its authorised users."*

We suggest the following rephrasing:

(i) *the exchange;*
(ii) *its authorised users;*
(iii) *issuers of securities listed on that exchange;*
(iv) *officers and employees of the exchange, its authorised user and issuers, and*
clients of its authorised users.

National Treasury response: Agreed. The suggested changes have been incorporated in 17(7).

General amendments relating to exchanges

new 8(1)(a) - The Bill does not require that assets and resources be located in the Republic; this requirement will be left to Minister discretion that will be influenced by the category of market player being contemplated, and the risks that requiring local assets might result in (for example requiring a local clearing house for OTC derivatives would not necessarily reduce systemic risk as the capital for the clearing house will be borne by the largest banks, potentially placing their balance sheets at risk should a large failure occur in the settlement cycle). Equivalent changes are effected for each of the market infrastructure, to include CSDs, clearing houses and trade repositories. Also see the explanation given on clause 5(6) above.

new 8(1)(b) - engagement with stakeholders has revealed a concern that governance requirements, similar to those imposed on trade repositories, were absent for the SRO market infrastructure. This omission was intentional - the licence obligations of the SROs are onerous and incorporate elements of governance. However it is agreed that the principle of good governance should be entrenched in the law, and is therefore included in the revised draft under the relevant exchange, CSD and clearing house sections. Further, this is in line with IOSCO principles of governance arrangements for market infrastructure.

new 10(1) - This principle is carried across from the sections that deal with the users of the market infrastructure in their dealings with each other; it was considered appropriate that principles of fairness and transparency also be required of the market infrastructure in respect of their dealings with their users, especially in the context of the SROs behaving as both commercial entity and regulator. This principle is similarly applied across the CSD, clearing house and trade repository chapters.

new 10(2)(j) - this clause gives express accommodation of the "integrated" clearing model of the equities market in South Africa, where clearing is effected by the JSE and Strate rather than a separate clearing house. National Treasury is of the view that this model should be phased out going forward as introduces a blurring of responsibility and accountability in the regulatory framework as clearing is licensed under the exchange rather than clearing house chapter. This implies a different focus of the Registrar in his or her supervision of the entity and activity - a focus on trading rather than clearing, important given the systemic risk that a clearing failure may bring. However this debate must form part of the broader one on market structure and the SRO model. As such the model is retained in this Bill, although provisions in the exchange and clearing house chapters are aligned to ensure that the full set of requirements imposed through the clearing house chapter is mirrored in that of the exchange. See therefore this new 10(2)(j) and 17(2)(f).

new 10(2)(l) - This provision recognises the role of market infrastructure in ensuring systemic stability, and read together with the new clause 6(3)(o) already discussed, ensures that the right regulatory role players are getting the right information at the right time in order to identify and mitigate contagion risks.

new 17(2)(f) - This clause is explained above, in relation to the new clause 10(2)(j).

new 17(2)(s) - Engagement by the National Treasury with stakeholders revealed a concern that the SROs exert significant power in their dual roles as profit-making infrastructure provider and regulator. To enhance accountability of the market infrastructure to its users, it is proposed that a complaints mechanism be provided for in terms of its rules, which rules are subject to public consultation and Registrar approval. This strengthening provision should be read together with other reform clauses, for example the way in which rules are made - revised Bill clauses 71(1), 71(2) and 71(3)(c), and strengthening of additional business and conflicts of interest clauses - clauses 61 and 62 respectively in the August Bill. An equivalent clause is included in the CSD, clearing house and trade repository chapters.

new 17(2)(w) - This clause is intended to support transparency in price-setting by the exchange; equivalent clauses are carried through to the CSD and clearing house chapters.

new 17(2)(cc) and **(dd) -** This issue is explained under the definitions section above, specifically in the definition of inter-dealer broker. In sum, these persons are considered a special category of authorised user, and should be regulated as such. Should these persons prefer not to report into or be answerable to an exchange, then they would need to take responsibility for operating an exchange themselves, and would be subject to the exchange chapter. This should safeguard against regulatory arbitrage - a person should not be able to elect his or herself out of the regulatory net.

CHAPTER IV: CUSTODY AND ADMINISTRATION OF SECURITIES

Segregation of securities

21(1)

> "Every authorised user must deposit securities held by it for its own account and for or on behalf of its clients in separate securities accounts and must ensure that securities held for or on behalf of its clients are identifiable as belonging to a specific person."

Does this mean that authorised users must have two accounts at Participant level?

21(2)(a)

> *"Every authorised user must balance and reconcile the aggregate number of each security reflected in securities accounts maintained by the authorised user, and held by a participant, a central securities depository or another third party on behalf of the authorised user and its clients, with the number of securities held by the participant, central securities depository or other third party, on a daily basis unless otherwise provided for in the exchange rules."*

We also note section 18 on page 31 of the Explanatory Memorandum – *"This effectively means that daily balancing with the upper tier custodian, i.e. participant, CSD or a third party will be required of authorised users."*

When will authorised users be required to balance their accounts with a Central Securities Depository or other third party as only Participants or External Participants have accounts with the Central Securities Depository (CSD)?

National Treasury response: In response to the first question raised about two accounts at participant level, the answer is yes, at a minimum. To the second part of the comment, the commenter may have misinterpreted this section to mean that by including daily balancing the balances, does not say who is doing it. Placing obligation on authorised user to balance their records is not incorrect.

Functions of licensed CSD and powers of the registrar to assume functions

29(1)(r) (now 30 (1)

We are supportive of this provision which requires that a licensed central securities depository must conduct its business in a prudent manner and with due regard to the rights of participants, clients and issuers. However, we note with concern that a similar requirement has not been provided with regards to the manner in which an exchange and a clearing house must conduct its business.

National Treasury response: A new 30(1) has been added as a principle, not as function therefore 30(1)(r) has been take out .and extend to other market infrastructure. New 30(1) reads as*: "…a licensed central securities depository must conduct its business in a fair and transparent manner, with due regard to the rights of participants and their clients."*

29(1)

Functions of central securities depository

"A licensed central securities depository –

(j) "must balance and reconcile the aggregate of the central securities accounts with the records of the relevant issuer—

*(i) in respect of **certificated securities** of the same kind, not less than once every six months;"*

We do not see the need for this as the CSD has no jurisdiction or involvement in the certificated environment and should not be responsible for balancing certificated records?

29(1)

(q) "may enter into an agreement with an external central securities depository for the provision of securities services in the Republic for or by the external central securities depository;"

Strate (the CSD) is taking on custody and settlement risk at the same level as that of its participants and may also enter into agreements with external CSD Participants. Are there capital adequacy requirements and risk measures in place for the CSD to mitigate the custody and settlement risk? As external CSD's are currently clients of existing Participants, our view is that Strate will be competing with Participants.

National Treasury response: A CSD would only be able participate in an arrangement as the one raised subject to Ministerial regulations and requirements prescribed by the registrar. Further, the CSD would have to ensure that adequate risk mitigation measures are in place. The section referred to above is meant to be an enabling provision for external participation.

29(1) and 49(1)

It is a matter of utmost importance to correctly define the duties and functions of a SRO in the FMB as this has to be clearly distinguished and differentiated from *"securities services"* that are provided by authorised users of SROs. Put differently, SROs do not provide securities services nor should they be allowed to provide securities services as SROs exercise regulatory duties and functions as contemplated in the FMB.

The exchange chapter of the FMB correctly reflects this principle and our understanding was that fundamental principle should be equally applicable to the CSD and clearing House chapters. This however not the case and the CSD section (section 29(1)(s) and (t)) and the Clearing House Section in section 49(1)(e) still refer to a SRO that *"...may provide securities services to the extent necessary to perform the* (regulatory)*functions..."* of a SRO.

National Treasury response: In principle the NT agrees that the CSD should not be able to provide securities services as explained above. According to the definition of a central Securities Depository, the CSD is a provider of infrastructure, even for Securities Ownership Register (SOR) will not hold securities directly; they must go through the participant.

In terms of the functions of a licensed CSD, new s30(1) extended to include *"…must conduct its business in a fair, efficient and transparent manner, with due regard to the rights of participants and their clients…"*, and consequential amendments to the related section for an exchange (s9(1)) and a clearing house (s50(1)) have been added.

Furthermore, neither a CSD nor a Clearing House is capable of performing *"securities services"* as defined in section 1 of the FMB. The only securities services that could conceivably be performed by a CSD are custody and administration or settlement. Both these services are however defined in such a manner that CSDs and Clearing Houses are precluded from performing these services as custody and administration may only be performed by a participant or nominee and settlement services may only be performed by a participant, and authorised user or a clearing member.

In addition hereto, the FMB clearly states in sections 29(1)(v) and 49(1)(f) that a CSD and Clearing House may do all things that are necessary for, incidental or conducive to the proper operation of a CSD and Clearing House. There is therefore no need to enable a CSD or clearing House to provide *"securities services"* to enable them to fulfill their regulatory duties and responsibilities as all SROs are already empowered and, in fact, obliged to do all things necessary to ensure that they comply with their regulatory obligations.

We therefore request that the CSD and Clearing House chapters be amended to consistent with the exchange chapter and that sections 29(1)(s)(t) and section 49(1)(e) be deleted and the primary licensed duties, functions and obligations of a CSD relating to the holding of uncertificated securities, the making of entries in an uncertificated securities register and the settlement of transactions in such securities be appropriately defined in section 29.

National Treasury response: Agreed. The term "*securities services*" was replaced with "*functions*".

We refer to the written submission of the JSE with regard to the description of the Central Securities Depository functions and the use of the term "*securities services*" in section 29 of the Financial Markets Bill ("FMB"). We herewith furnish you with Strate's comments and suggested amendments to the FMB for your consideration.

We request that section 29(1)(s) be deleted as motivated below in paragraph 4. We further request that the following new subsections be added to section 29(1) to describe the functions of the Central Securities Depository ("CSD"):

*"**29.** (1) A licensed central securities depository –*

> 3.1. *(*new) must constitute, maintain and provide an infrastructure for holding uncertificated securities which enables the making of entries in respect of uncertificated securities;* [Please see identical wording in S1definition of CSD – note this is different from "*entry*" section in 29(1)(i)]
>
> 3.2. *(*new) must constitute, maintain and provide an infrastructure which infrastructure will include a securities settlement system;* [Please see identical wording in s1 definition of CSD]
>
> 3.3. *(*amended_u) must "establish and maintain efficient, effective and sustainable infrastructure to perform the services for which it is licensed*; [Please see s29(1)(u)]
>
> 3.4. [Please read the above paragraphs 3.1.3.2 and 3.3 with section 29(1)(v): *"may do all other things that are necessary for, incidental or conducive to, the proper operation of a central securities depository and that are not inconsistent with this Act".*

National Treasury response: Agree with these changes, except 3.3 which should read *functions* where it currently refers to *services*. The recommended wording has been incorporated

Depository rules

> Section 34(2)(r) should read *"...must provide that no participant may open a securities account or a central securities account **[with]** for a person whom the participant believe..."*

National Treasury response: National Treasury agrees and the proposed change has been effected.

Registration and ownership of securities

> The following provision has been duplicated in sections 35(3) and 36(5)
>
> *"Any securities held by a central securities depository, participant or nominee for on behalf of another person must be identifiable as belonging to a specific person, and are considered to be trust property as defined in the Financial Institutions (Protection of Funds) Act, and that Act applies to those securities."*

National Treasury response: Agreed, the section has been taken out from s35 and s 36 remains as is.

Pledge or cession of securities or interest in uncertificated securities

> **38(1)**
>
> *Pledges*
>
> Section38(1)(a) has been amended to state:

> *"A **pledge or cession to secure a debt**, in respect of securities or an interest in securities held by a **central securities depository, participant, authorised user or nominee**, as the case may be, **must be effected by entry in the central securities account or the securities account**, as the case may be, of—*
>
> *(i) the pledgor in favour of the pledgee specifying the name of the pledgee, the interest in the securities pledged and the date; or*
>
> *(ii) the cedent in favour of the cessionary specifying the name of the cessionary, the interest in the securities ceded and the date, as the case may be."*

We agree with the amendment to the section "*to clarify that the required entries in respect of pledges and cessions should be effected at the level of holding."* Our concern is that section 34(2)(k) states that:

> *"the depository rules: must provide for – (i) the duty of persons for whom securities accounts or central securities accounts are kept to disclose to a participant or central securities depository, as the case may be, and the duty of a participant to disclose to a central securities depository, information about a beneficial, limited or other interest in securities deposited with the participant or central securities depository, as the case may be;…"*

We feel it should be clarified in this section that this obligation applies only where the pledge has been disclosed to the Participant. There are instances where the Participant may not be advised of pledges recorded by the broker and we cannot be expected to disclose or report details to the CSD if we do not have the information ourselves. While section 38(1)(a) provides for entry at the level of holding which is what the market players requested, our reading is that section 34(2)(k) will mean that the broker (where the broker nominee is the client of the participant) is obligated to report all pledges to their CSD participant. There are practical difficulties where there are large volumes of pledges being recorded and uplifted in a short period of time, to record and then reverse these pledges at CSD participant and CSD level. We therefore feel that these clauses contradict each other.

National Treasury response: Agreed just to leave as is in SSA. The rules will provide for the details of disclosure.

38(1)

Pledge or cession to secure a debt

Section 38 of the FMB deals with a pledge or cession to secure a debt. In so doing, pledge and cession are being treated interchangeably when in fact they are distinctly different.

According to Law of South Africa, a pledge is a limited real right of security in a movable asset, created by delivery of the asset to the pledgee pursuant to an agreement between himself and the owner of the asset, by which it is sought to secure the fulfilment of an obligation due to the pledges by the pledgor, or some third person.

The Law of South Africa further states that because the rights embodied in negotiable instruments are closely identified with the paper, the pledging of such documents results in these rights forming part if the pledgee's security. There has been a view expressed that transactions of this kind are of a composite nature, consisting of a pledge of the paper and a cession *in securitatem debiti* of the rights against the debtor embodied in them.

In *Grobler v Oosthuizen* 209 (5) SA 500 (SCA) the court discussed the two *"theories"* with regard to cession in *securitatem debiti* in detail, the main points of which are summarised below:

(1) according to *"the pledge theory"*, the effect of the cession *in securitatem debiti* is that the principal debt is "pledged" to the cessionary while the cedent retains what has been described as the "bare minimum" or a *"reversionary interest"* in the claim against the principal debtor; and

(2) according to the second theory, a cession *in securitatem debiti* is in effect an outright or *out-and-out cession* on which an undertaking or *pactum fiduciae* is superimposed that the cessionary will re-cede the principal debt to the cedent on satisfaction of the secured debt. In consequence, the ceded right on all its aspects is vested in the cessionary. After the cession *in securitatem debiti* the cedent has no direct interest in the principal debt and is left only with a personal right against the cessionary, by virtue of the *pactum fiduciae*, to claim re-cession after the secured debt has been discharged.

The court held that despite the doctrinal difficulties arising from the pledge theory, the Supreme Court of Appeals had in a series of decisions leading up to this case, primarily for pragmatic reasons, accepted the pledge theory in preference to the outright cession/ *pactum fiduciae* construction and consequently the doctrinal debate must be settled in favour of the pledge theory.

In annexure A to the Explanatory Memorandum, the issue of cession and pledge is discussed. One commenter suggested the word *"pledge and cession"* be replace with "cession *in securitatem debiti"* in order to make it clear that this section deals with a pledge and not an out-and-out cession.

According to Treasury's view, it was decided to retain the phrase *"cession to secure a debt"* as the correct legal term used for *"incorporeals"* (such as securities) and also plain English for "cession *in securitatem debiti".* The FMB, according to Treasury, clearly distinguishes between "pledge in cession to secure a debt" in terms of section38(1) and *"out-and-out cession"* as set out in section38(2). The intention is to provide for pledges as wells as for out-and-out cessions.

The issue with Treasury's view is that it is suggesting that pledge and cession *in secutitatem debiti* are two different concepts, when in fact they are not. Presumably what is meant by "the intention is to provide for pledges as well as for out-and-out cessions" is that the intention is to provide for cessions *in securitatem debiti* (which means that the pledge theory applies, per *Grobler v Oosthuizen)* and out-and-out cession. This means that there is no need to refer to both pledge and cessions *in securitatem debiti* and we therefore recommend that references to pledge be deleted.

National Treasury response: See above

38(1)

Pledge or cession of securities to secure debt

Section 38 of the FMB amends and replaces section 43 of the SSA. According to the FMB Explanatory Memorandum dated April 2012, section 43 has been amended to clarify that the required entries in

respect of pledges and cessions should be effected at the level of holding and to make the entry effective to third parties. This is to align the FMB with the Companies Act, 2008 and give effect to UNIDROIT. Whereas section 38 works when dealing with a pledge between two parties who intend to pledge the asset over a long term, we believe that the implementation of this section is not practical for prime brokers. Prime Brokers often deal with a number of clients with a large pool of assets in an actively traded portfolio. The current Strate Rules and Practise Notes provide for only one pledge to be registered over any share at any one time. Once pledged the shares a blocked for settlement. While this works very well for single and long term pledges, it presents a number of practical problems for an actively traded portfolio such as the prime brokerage portfolios. Recording the pledge over client assets becomes very labour intensive, manual and introduces an unacceptable level of operational risk. We believe therefore that there is a commercial need to consider another method of creating a pledge to secure a debt under section 38(1)(a). We would propose that the committee consider including a provision to allow prime brokers and broker –dealers to create a pledge over a viscous pool of assets similar to creating a floating charge in the UK, where the pledgor would create a pledge in the securities account in favour of the pledge specifying the name of the pledge, the interest in the uncertificated securities pledged and the date of entry as follow: Example: **XYZ Ltd Account Pledged to ABX Ltd 27 May 2012** **Anglo** **200** **Amplats** **300** **SAB** **500** The Prime Broker may then move the pledged assets in this account with the consent of the client in accordance with section 38(1)(b).

National Treasury response: Given the example given by the commenter, it would seem impractical to put a flag only to lift the flag again. To do it in one day does not seem sensible, nor cost effective. what is being proposed rather to address the issues raised by the commenters therefore is to use floating charges. Through these means, the participant is able to keep a book of who the players are in the account, without having to but don’t have to do for each security. The proposed wording to amend the section is extracted from UNIDROIT. The commentators concerns are on the inadequacy of the South African security arrangements. The purpose of these sections is to replicate equivalent requirements for the registration of transfers and pledges in the context of uncertificated shares. We are retaining the provisions relating to pledging and out-and-out cession. It would be better to deal with this issue through the Taxation Laws Amendment Bill process on Securities Transfer Tax.

CHAPTER V: CLEARING HOUSE

Functions of licensed clearing house

51 This section may not be required if the intention was to exclude "mutual associations" by the use of the term *"juristic person"*. See comment in respect of section1 above.

National Treasury response: The issues raised above have already been dealt with.

General comments and amendments relating to the clearing house

new 48(1)(a) - see explanation given above of clause 8(1)(a), to be likewise read together with 5(3).

new 48(1)(b) - see explanation given above of clause 8(1)(b).

new 50(1) - see explanation given above of clause 10(1).

deletion of tabled Bill clause 49(1)(e), revised Bill clause 50 - To contain conflicts of interest, a market infrastructure, especially one that has regulatory functions, should not be able to compete with its users. This clause is already effected across the other market infrastructure chapters, and hence this deletion ensures consistency.

new 50(3)(i) - see explanation given above of clause 17(2)(w).

new 50(3)(j) - see explanation given above of clause 10(2)(l).

new 53(2)(n) - see explanation given above of clause 17(2)(s).

new 53(2)(r) - see explanation given above of clause 17(2)(w).

new 53(2)(z) - This new clause is required to give effect to the principle of segregation in the clearing environment, which deals with collateral. Segregation is necessary to protect client or counterparty funds in the case of an insolvency or other contamination of a related party's funds. The enabling clause is also aligned with the CPSS-IOSCO principles for market infrastructure.

National Treasury: The concerns related to whether the exchange that performs some form of clearing would be required to have a clearing house (associated) license. This requires a separate clearing house licence to accommodate the clearing function currently performed by the JSE. The question raised was how much of a shift in the current business model the imposition of a clearing house licence would for instance, to the extent that the licensing requirements in the FMB specify a governance structure, such as for a separate Board of Director, it would not necessarily require a new the SAFCOM Board of Directors, and whether these changes justify the additional costs.

However, shift towards the optimal model will have different consequences for authorised users, depending on whether they are controlled or authorised users. The subsequent impact of the changes will mean that the definition and rules, particularly s16(2)(f) will need to be consequentially changed.

CHAPTER VI: TRADE REPOSITORY

Application for trade repository licence

54(2)

By prescribing that an applicant for a licence for a trade repository may only be a "company incorporated in terms of the Companies Act" effectively excludes an application from a foreign transaction repository from applying to fulfil the duties of a trade repository in terms of this Act. We submit it is necessary that the Act is not prescriptive as to the locality of a trade repository and that the requirement for the licensing of a trade repository is consistent with the licensing requirements of self-regulatory organisations. We suggest that this sub-section is amended as follows:

> *"(2) A* ***[company incorporated in terms of the Companies Act]*** *juristic person may apply to the register for a trade repository licence for one or more types of unlisted securities referred to in the definition of securities."*

National Treasury response: The National Treasury agrees with the observation and the proposed wording has been incorporated. See additional supporting explanation given in the definition of "*juristic person*" and the response given to clause 5(6) above.

Licensing of trade repository

56(2)(c) & 56(4)

Potential facilitation of the licensing of an international trade repository

In respect of the potential facilitation of the licensing of an international trade repository, you could confirm that we would want to facilitate this. Would we potentially want to amend or delete in section56 sub-section2(c), and (4)

National Treasury response: National Treasury agrees with this submission, the proposed wording has been incorporated. See also the explanation given of clause 5(6) above.

General comments relating to the trade repository

new insertion to 54(1), 57(2)(b) on Minister regulations - Owing to the wide policy impact of the decisions made on trade repositories, for example with respect to which instruments should be reported on and the frequency of reporting, such will be subject to Minister regulation. These clauses ensure alignment across the relevant sections that will be subject to this regulation.

new 55(1)(a) - see explanation given above of clause 8(1)(a), to be likewise read together with 5(3).

new 55(1)(b) - see explanation given above of clause 8(1)(b).

new 57(1) - see explanation given above of clause 10(1).

new 57(2)(w) - see explanation given above of clause 17(2)(w).

CHAPTER VII: GENERAL PROVISIONS APPLICABLE TO [MARKET INFRASTRUCTURES]

The replacement of the term SRO with market infrastructure is explained in the definitions sections above. It is reminded that the SRO model has been retained; the term SRO is however superfluous and has therefore been replaced.

new 59, to replace clause 59 and 60 of the May Bill - Stakeholders considered the annual renewal process of the market infrastructure licence by licence holders as costly, cumbersome and superfluous; given the systemic nature of these entities, it is unlikely that a licence will ever by rescinded by the Registrar for non-compliance. This requirement has as a result been replaced by an annual assessment of the satisfaction of licence conditions.

new 61(1) - No licensed market infrastructure can conduct additional business that may introduce systemic risk.

Cancellation or suspension of licence

59, 60 & 61

Renewal, cancelation suspension of a licence of a self-regulatory organisation

The monopolistic structure of the financial markets infrastructure in South Africa has implications for the effectiveness of the sanctions that are available to the registrar should an SRO materially, or repeatedly, contravenes the provisions of the statute. While the Bill does give the registrar the power to take responsibility for the functions of an SRO, the registrar is not practically in a position to manage the commercial activities of an SRO. The absence of alternate market infrastructure providers implies that this sanction is ineffective when the commercial activities of an SRO are of systemic importance. For similar reasons, the ability of the registrar to sanction an SRO by not renewing its licence is also doubtful. It is proposed that the Bill remedies this by providing for administrative penalties and fines.

Section59 requires a SRO to renew its licence in advance of the automatic expiry of the licence on 31 December each year and Section60 provides the registrar with the power to refuse to renew the license. It is not clear what the operational status of a self-regulatory organisation ("SRO") would be if the annual licence was not renewed, other than suspension pending possible cancellation or outright cancelation, as envisaged in Section61.

In the extreme scenario of suspension or cancelation of a SRO's licence, the effect on the market would be substantial due to the current monopolistic financial markets infrastructure in South Africa -

- the registrar would not be able to *"transfer the business of the self-regulatory organisation to another similar self-regulatory organisation"* as currently only one exchange and one central securities depository exists in South Africa; and

- the *"business"* of these SROs is inextricably linked with the regulatory function performed by the SROs.

This leaves the registrar with one alternative in terms of Section61 –

"the winding-up of a self-regulatory organisation in terms of section 102".

Clearly this outcome is untenable as it would be contrary to the objects of the Act and would be disastrous for the financial markets and South Africa as a country. Although we believe that the expiry and renewal of the licences' of a SRO on an annual basis introduces operational and legal uncertainty and possibly systemic risk, our view is that the threat of refusal to renew a licence, suspension or cancelation of a licence is the only mechanism afforded to the registrar to sanction a SRO in the circumstances where a SRO fails to or inadequately performs its regulatory functions. Consequently, in the absence of broader sanction powers afforded to the registrar as advocated in paragraph 2.1 of our submission, we believe it is necessary to retain the expiry and renewal of annual licences of SROs.

We believe that the registrar should be able to renew the licence without contradicting any other intention. In this way, an orderly resolution of the underlying concerns of the registrar regarding the performance of an SRO of its regulatory functions can be affected without the registrar being forced to make a public announcement on the expiry of the license.

To this end we suggest that Section 59 be amended to reduce the obligation of the registrar to act at the renewal of the licence and propose the following insertion:

"<u>(3) A renewal of the licence by the registrar does not detract from any actions taken, or yet to be taken by the registrar under Section 61</u>."

This wording or similar wording should enable the registrar to reissue the licence whilst investigating the SRO and any subsequent decision by the registrar would not be inconsistent with the obligation to relicense. Furthermore, it is our view that Section60 does not provide an additional benefit to the registrar as each of the rights conferred under Section60 are already available under Section61 and we note that Section61 does not take into account the power afforded to the registrar to assume responsibility for the functions of an exchange, a central securities depository and a clearing house. Therefore we propose that Section60 be deleted in its entirety and Section61 is amended as follows:

"Cancellation, [or] suspension <u>or refusal of renewal</u> of licence

61. (1) The registrar may cancel, **[or]** *suspend or refuse to renew a licence if -*

(a) …

(2) The registrar must, before cancelling, **[or]** *suspending <u>or refusing to renew a licence</u>—*

(a) inform the self-regulatory organisation of the registrar's intention to cancel, **[or]** *suspend <u>or refuse to renew</u>;*

(b) give the self-regulatory organisation the reasons for the intended cancellation, **[or]** *suspension <u>or refusal to renew</u>; and*

(c) call upon the self-regulatory organisation to show cause within a period specified by the

registrar why its licence should not be cancelled, ***[or]*** *suspended or renewed.*

(3) …

(4) If the registrar cancels, ***[or]*** *suspends or refuses to renew a licence, the registrar must take such steps and may impose such conditions as are necessary to achieve the objects of this Act referred to in section 2, which steps may include—*

(a) the assumption of responsibility for one or more functions of a self-regulating organisation, as provided for in sections 9(2)(a),29(2)(a) and 49(3)(a);

[(a)] *(b) the transfer of the business of the self-regulatory organisation to another similar self-regulatory organisation; or*

[(b)] *(c) the winding-up of the self-regulatory organisation in terms of section 102.*

National Treasury response: At issue here are was the powers afforded to the Registrar in the event that a market infrastructure (for example an exchange) fails to satisfy its licence obligations. Given that licence functions give operational and supervisory responsibilities to the licence holder, such failure could imply weakness of either of these attributes. Notwithstanding, it is agreed that the regulator will never be in a position to assume operational responsibility for a market infrastructure as lacks, rightly, the resources to assume such a role. The Bill has therefore been revised to state that the Registrar can only take over supervisory or regulatory responsibility - see for example s10(3)(a).

Carrying on of additional business, and conflicts of interest

62 (2)

Proposed wording of conflict of interest insertion

"Any regulated person may lodge a conflict of interest between a self-regulatory organization's regulatory oversight of authorised users, participants or clearing members as the case may be.

*(**[2]**3) The registrar may, if the registrar is of the opinion that the business, function or service referred to in subsection (1) or (2) may -*

62 & 63

Conflicts of Interest

We have previously raised concerns regarding conflicts of interest, in that a Self Regulatory Organisation (SRO) sets compliance requirements which may be structured for the benefit of the SRO. Participants are required to obtain signed custody agreements from their clients, in which personal information such as email addresses, telephone numbers, identity numbers etc. are provided. As

Participants, confidentiality clauses form part of our standard agreements and this information is provided to us by our clients, with the understanding that it will only be used for purposes of investor communication from Issuers. The CSD, however, may provide securities services that compete with its participants and act as both regulators and for-profit service providers. We are pleased to note that the revised Bill separately defines the concept of regulatory functions versus securities services, that a SRO is expressly prevented from providing securities services that would be required to be regulated in terms of its regulatory functions and that there are more stringent parameters governing new business that a SRO may perform (section62 and 63). We note that a confidentiality section(section74) has been inserted and that information cannot be used for the benefit of the CSD. **Firstly, we continue to question how we can get comfort that Strate complies with the confidentiality created between ourselves and our clients**. Secondly, disclosure of information for the proposed central register (Securities Ownership Register) should be limited to the name, address and number of shares (as per the current market practice) and should be used for the purposes of *"real-time transparency and as a management and monitoring tool"*, but should not be used for the CSD's personal gain. We are aware that the CSD already sells information for their own gain and this should be prohibited. **Our overriding concern remains the SRO model and how this will be regulated.** The revised Bill provides that the SRO must take steps to manage its conflicts of interest, which steps must be transparent, open to public scrutiny and subject to annual self-assessment (section63). We believe strongly that this self-assessment should be independent and be conducted by the FSB or an independent third party.

National Treasury response: A new clause in the rules section has been added to address the procedures and processes that market infrastructure must undertake to ensure an effective complaints mechanism, such as the new s17(2)(t).

National Treasury's view is that having such a clause is tantamount to upholding the Administrative Law principle for individuals' rights to be heard. The intention is to ensure that other channels exists through which concerns may be addressed where a person is not satisfied with a particular way its complaint has been handled by the SRO. There is a need to articulate such a process to "hear" without going through the dispute resolution path. This may also create a paper trail for complaints escalated to the Registrar. Further, the rule does not necessarily influence or determine the outcome of the process. The intention is that for *any* complaint there should be a process or channel by which any entity wishing to lodge a complaint is empowered to do so. Further, any concern by a market user as relating to a market infrastructure can be voiced to the Registrar's office at any time.

Regarding the concern relating to the use of confidential information, clause 73(1) provides that such information may not be disclosed other than in the circumstances referred to in the section. Furthermore the contravention of this section has now been criminalised – see clause 109(d).

Regarding the complaint that the assessment of conflict of interest must be independently made, the National Treasury is of the view that the publishing of the assessment ensures transparency and as such any person not in agreement with the findings may lodge a complaint with the registrar.

Securities Ownership Register (SOR)

68

We note that the SRO model will be reviewed as part of the broader financial regulatory reform towards a Twin Peaks model and we will certainly participate in the review process. A concern was raised in our initial comments, that as the JSE holds 45% of Strate, control effectively rests with them. Ownership is restricted and the JSE has the right of first refusal on all shares that might become available for sale (up to 49%). The JSE (a SRO) controls Strate (another SRO) and this entrenches what in our view is an unhealthy, anti-competitive integrated market structure. **What makes this much more concerning is that the proposal for the SOR is that it will be 100% owned by Strate.**

While we welcome the measures that have been inserted in the revised Bill to avoid or reduce conflicts of interest, we are still concerned about section68 regarding shareholdings and ownership of a SRO, as this sectionhas remained unchanged. The Registrar may approve the acquisition of shares or any other interest in a SRO in excess of 15% up to 49% and the Minister may approve a shareholding or acquisition exceeding 49%. We reiterate that in our view, **every market player/CSD participant should be given the opportunity to own up to 15% of the proposed SOR and they should be allowed to do the same in Strate** (as was the case before). All efforts by ourselves in the past to buy interests in Strate have been rejected on the basis of the original shareholder agreement between the JSE and other participants.

National Treasury response: The National Treasury believes that this is a misunderstanding of the role of (and functioning) a CSD. The CSD cannot have unlimited authority to impose requirements on market participants relating to the SOR, as requirements must be consistent with the function of the SOR, as determined by the Registrar. Further, the National Treasury also believes that this that an SOR as a holding structure can never be “owned” as contemplated by the commenter.

CHAPTER IX: PROVISIONS RELATING TO UNLISTED SECURITIES AND NOMINEES

Powers of the Registrar in respect of unlisted securites

77

This section should include a statement to the effect that the conditions and requirements for securities services for unlisted securities ought not to be more stringent, *mutatis mutandis*, than those for listed securities, i.e. establish equivalence in the relevant set of rules.

Regulations

In terms of section 77 of the FMB, certain aspects of the regulation of unlisted securities (ie the requirements for the authorisation of persons providing securities services in respect of unlisted securities) will be dealt with in the regulations. This will be problematic if these are not put through a consultation process. In our view it is imperative to have a financial market that is fair and transparent.

77

General comments on Unlisted Securities (Section77 in August and revised Bill)

We refer to page 31 of the Explanatory Memorandum: Annexure A "Treasury comments on issues raised during the consultation period".

We indicated in our previous correspondence that whilst we agree with the need for regulation of unlisted securities and OTC trades, we do not see the need for Strate to have any jurisdiction in the certificated environment. It should only regulate securities that have been dematerialised.

> *"**Treasury View**: The CSD is not responsible for balancing "certificated records" but to reconcile with the specific issuer its total issued share capital – which consists of uncertificated securities and certificated securities. It must be remembered that companies no longer have shareholder details of those shareholders holding securities in uncertificated form. For this the company relies on the CSD. Section 50(2)(a) of the Companies Act requires the company, after issuing any securities, to enter the "total number of those securities that are held in uncertificated form" in the paper register required by law and kept by issuers or their agents for certificated securities. This number of the dematerialised portion of the uncertificated securities register is referred to as the "balancing number" on the register of the issuer. In other words, to ensure proper reconciliation, the issuer relies on the CSD to ensure that there is no "over-issue" on its total issued share capital…"*

We do not agree with this view as this role is performed by the Issuer Agent in practice.

National Treasury response: The National Treasury notes this concern and after much deliberation, it was concluded that there is no other cannot do it any other way. There still needs to be mechanism to marry certificated and uncertificated and this can only be done at the CSD level with issuers.

78

Approval of nominee

We note that in *Chapter IX "Provisions relating to unlisted securities and nominees"* and in terms of section 78 which deals with the *Approval of Nominees*, that all nominees must be approved either by the Exchange, the CSD and in all other cases by the Registrar, before it can function as a nominee. At one of the workshops we raised the concern that while we apply these requirements for dematerialised securities, there are some existing historical certificated securities accounts which may be registered in the name of nominees which have not been approved. These accounts were opened at a time before the requirements were legislated. There may also be *"lost shareholders"* where shareholders have not notified the Issuer Agent of their change of address etc. so we may not be in a position to contact these shareholders.

We raised the question as to whether we would be required to enforce these requirements for certificated shareholders and whether we should freeze these accounts. The FSB indicated at the time that they would look into this matter but said that the practical difficulties should be taken into consideration.

We have not to date had any feedback regarding this issue.

National Treasury response: The National Treasury notes this concern , however the problem is not one to be addressed in the Bill.

CHAPTER X: MARKET ABUSE

Insider trading

80(now 78)

For ease of reference, a comparative analysis of the provisions in the SSA has been prepared and is attached to this submission as Annexure "A".

A new defence (section 80(1)(b)(ii) and 80(2)(b)(iii)) has been included for transactions amongst insiders, where the transaction is not aimed at securing a benefit from the price sensitive information. It excludes an offence where all the parties had the same information, the trading was limited to the same parties and there was no aim at securing a benefit from exposure to movement of the price of securities.

This defence may be too wide and too vague a defence. Firstly, one will need to qualify what is meant by *"the same inside information"*. Does it mean that all of the inside information that the parties have should be the same or will it suffice if all the parties share some of the same inside information? Secondly, what is meant by *"...the transaction was not aimed at securing a benefit..."*? Would one apply an objective or subjective test? If the test is subjective it would be easy for an insider to prove that, subjectively, the transaction was not aimed at securing a benefit, thereby escaping the offence.

As with the SSA, a corporate can be an insider. This means that if one division of a corporate possesses inside information which another does not and the latter trades, the corporate may be regarded as having committed an offence. A *Chinese Wall* defence would cure this problem.

80(1)(a), 80(2)(a) & 80(5)(a)

All the offences talk to the securities *"which are likely to be affected by [the inside information]"*. It is believed that it is the **price** that is affected by the inside information, not the securities themselves. Therefore, in sections 80(1)(a), 80(2)(a) and 80(5)(a), reference to *"securities"* being affected, should be replaced with *"the price of securities"* being affected.

80(2)(b)(iii)

This provision is curious and seems to reward cartel-type behaviour. Does this provision not offend against competition law principles?

National Treasury response: Chapter 10 of the Financial Markets Bill refers to the Market Abuse section. The Bill addresses several offences and contraventions, including insider trading, market manipulation and false/ misleading statements. Section 73 of the SSA had dealt with Insider Trading. s78(3) of the FMB extends the provision capture any individual (i.e. not necessarily an insider) who is "*dealing for an insider*" as committing an offence.

"....(3)who deals for an insider directly or indirectly or through an agent in the securities listed on a regulated market to which the inside information possessed by the insider relates or which are likely to be affected by it, ***who knew that such person is an insider.....****"*

The "Safe Harbour Defence" has been strengthened under s78(1)(b)(ii). The defence is available to an insider who, on the back of a balance of probabilities, may be found to be not guilty of an offence if they can prove they were acting in pursuit of a transaction in respect of which all the parties to the transaction had possession of the same inside information and that trading was limited to those very same parties referred to ; and that the transaction was not aimed at securing a benefit from exposure to movement in the price of the security, or a related security, resulting from the inside information.

Prohibited trading practices

82(1) (now 80)

Prohibited trading practices

ASISA members are of the opinion that section82(1)(b) introduces an exceptionally high standard of care in that it refers to a reasonable suspicion and not actual or reasonable knowledge. We submitted a similar comment on the sectionin the first draft of the Bill and also on the sectionthat has been replaced by section80(3)(a) of the published Bill. Section80(3)(a)provides that any person who deals for an insider and knew that such person is an insider commits an offence. It is uncertain why the concept of reasonable knowledge has not similarly been included in section82(1). ASISA members are of the opinion that the sectionshould be amended to provide that no person who knew that he or she is participating in a practice referred to subparagraph (a), may participate in such practice.

82(1) & 82(2)

Market abuse

We would like to draw your attention to the fact that (in line with the corresponding section of the SSA) actual knowledge of the offender is an element of the offense. It may contribute a complete defence against the charges preferred against a person if he alleges that he did not have knowledge, i.e.*"I did not know"* that for example, his actions were deceptive.

We are of the view that it may be appropriate and desirable to hold a person liable if the weight of the evidence shows that (apart from his denial) he either knew, of that he reasonable ought to have known that his actions were deceptive. Knowledge of the unlawful action equates to intent in the form of *dolus directus* in that the offender subjectively realised or appreciated the fact that his actions were deceptive, the JSE is of the view that a person who reasonably ought to have known, i.e. he was negligent, should also be guilty of an offence.

The JSE therefore requests that you consider an amendment to section 82(1)(a) to include *"reasonably ought to have known"* as part of this offence.

The JSE is also of the view that the ambit of this definition should be expanded to also include instances where a false or deceptive appearance of the demand for, or supply of trading activity has been created. The unlawful conduct would therefore not be limited to actual trading activity but would appropriately be extended to also include the unlawful entering of bids and offers in respect of transactions in securities.

National Treasury response: Concern was raised that a trader could be criminally liable in situations where they are only guilty of an oversight (negligence). *"Reason to suspect"* in first draft of the FMB has been replaced with *"ought - reasonably to have known"*. The FMB introduces negligence as a fault element and Treasury is of the view that the sanction in such event should only be an administrative penalty. However, knowingly participating in a prohibited trading practice is still a criminal offence.

82(3)

Section 82(3)(a) contains an exception to the definition of offences as stated in the other subsections of section 82(3). In summary, all the offences defined in section 82(3) have an unlawful intent at the root of the offensive trading practices, for example, *"false or deceptive appearance of public trading"*, *"an artificial market price"* and *"...to defraud..."*.

Section 82(3)(a)amounts to a deeming provision and stipulates that, regardless of the intent or motive of the parties to the transaction, the transactions mentions in (a) are unlawful, prohibited and constitute an offence.

We reiterate our objection, in principle, to the contents of this section as there are many examples and instances of transactions that are lawful, that have been concluded for lawful purposes, that have been concluded in the absence of any intention or motive to create artificial prices, to defraud or to achieve any of the other unlawful objectives mention in 82(3) yet these transactions will now, as a result of the strict liability envisaged by this deeming provision, be prohibited and criminalised. For example, a transaction between a subsidiary and its holding company and unintentional matches of order for the benefit of the same counterparty on the central order book would constitute unlawful conduct and a criminal offense as a result of the deeming provision of this section.

We therefore request the inclusion of the unlawful intent element by subsections (i) and (ii) of section 82(3)(b) as elements of the unlawful conduct prohibited by section 82(3)(a). The FMB should prohibit and punish unlawful conduct and the identity of the parties should not be the deciding factor to determine whether the conduct is permissible. This is already achieved by subsections(3)(b)-(i).

The JSE is also for the view that the existing wording of section 89 may lead to confusion as a result of the wording of section 82(3). It is unclear from the existing wording whether the legislator has intended to ensure that the examples of conduct mention in subsection (3) in itself satisfy all the elements of the offense defined in subsection 82(1)(a), or whether, in addition to these requirements, the external effect of these actions, as contemplated in (i) and (ii) of this subsection, also have to be proven. We therefore request that this section be amended to ensure that the intention of the legislator is clear, unambiguous and apparent from the wording used in these provisions.

National Treasury response: Agreed. The deeming provisions of the draft FMB have been changed to examples of contraventions and section 82(3) of the new draft now reads as follows:

> *"(3) Without limiting the generality of subsection (1), the following are* ***[deemed to be manipulative, false or deceptive trading practices]*** *<u>contraventions</u> of subsection (1):*
>
> *(a)approving or entering on a regulated market an order to buy or sell a security listed on that market which involves no change in the beneficial ownership of that security, <u>with the intention of creating-</u>*
>
> *<u>(i)a false or deceptive appearance of the trading activity; or</u>*
>
> *<u>(ii)an artificial market price for that security</u>..."*

The definition of the offence now refers to only the effect of the transaction and not to a manipulative practice.

The extended definition of *"beneficial ownership"* in section 82(3)(a) is also problematic as it is contrary to the well established meaning of this term in South African law. A beneficial owner denotes the person in whom, between himself and the registered shareholder the benefits of the bundle of rights constituting the share vests. It would be more appropriate to rather specifically define, for the purposes of this section, what exactly is meant and what would constitute *"...no change in the beneficial ownership of that security..."*. We therefore suggest that this term be specifically defined in this section.

National Treasury response: As a result of the aforesaid amendment to section 82(3)(a) the extended definition of beneficial ownership becomes less problematic. For the sake of clarity the extended definition of beneficial ownership was moved from s82(3)(a) to a new s82(5) ofthe new draft:

> *"(5) For the purposes of subsection 3(a), a purchase or sale of listed securities does not involve a change in beneficial ownership if a person who had an interest in the securities before the purchase or sale, or a person associated with that person in relation to those securities, has an interest in the securities after the purchase or sale."*

Liability resulting from insider trading

84(1) *Liability arising from insider trading* ASISA members support the removal of the provisions relating to the possible fines and settlement in that it is unusual to include the extent of the liability and the detail relating to how the liability is calculated in legislation. We recognise that the enforcement committee must follow administrative justice processes and cannot exercise its discretion in an unreasonable and inconsistent manner and any

penalty award must relate to the damage or loss suffered. However, ASISA members believe that the enforcement committee should in legislation be required to publish the principle and guidelines to be used in determining any penalties and the means of calculating those penalties.

84(1)

The JSE is of the view that this section contains an unnecessary and perhaps unlawful duplication of the penalties that may be imposed as a result of the FMB. The Financial Institutions (Protection of Funds) Act already provides for the imposition of a penalty for punitive and compensation purposes and an offender cannot be punished twice for the same offence.

We therefore suggest that section 84(1) be amended to read as follows:

> *"Any person who contravenes section 80(1),(2),(3),(4) or (5) of this Act is, in addition to any administrative sanction or cost order that may be imposed, also liable to pay to the board a penalty for punitive and compensatory purposes, in the sum determined in the enforcement committee, as contemplated in section 6D of the Financial Institution (Protection of Funds)Act."*

We also wish to point out a consequential amendment to the FI Act as point 2 of the amendment on page 171 of the FMB should rather refer to Chapter X and not Chapter IX.

National Treasury response: Under the previous SSA, where an offender did not make a profit (or a small profit due to the market moving in the opposite direction, no penalty could be imposed. Accordingly the latest proposed s84(2) strengthens the maximum penalty and will have the profound impact where an offender does not make a profit in the sense that a penalty of up to R1m can still be imposed i.e (i) the profit made or the loss avoided, (ii) *an amount of up to R 1 Million* plus three times the profit made or loss avoided, (iii) interest, (iv) commission and (v) the cost of suit.

The "three times penalty" provision of the SSA was removed in the first FMB draft which made provision for the EC to impose any penalty in terms of the FI Act (this is similar to the market manipulation and false reporting penalties). The "three times profit penalty" has however proven to be beneficial during enforcement proceedings and is also a standard that is used internationally in insider trading cases. We thus endeavoured to retain it. Further, it will tie in with the interpretation of Section 6 of the Financial Intelligence Act.

Powers and duties of Financial Services Board

86(4)(a)

Powers and duties of the Financial Services Board

The words from *"commits an offence and is liable..."* should drop down as it should be applicable to subparagraphs (i) to (v):

"any person who has been duly summoned under subsection(3)(a) and who, without sufficient cause-

(i) fails to appear at the same time and place specified in the summons;

(ii) fails to remain in attendance until excused from further attendance;

(iii) refuses to take the oath or to make an affirmation as contemplated in subsection (3)(b); or

(iv) fails to answer fully and satisfactorily any question lawfully put to him or her under subsection (3)(b); or

(v) fails to furnish information or to produce a document in terms of subsection (3)(a),

commits an offence and is liable on conviction to a fine or to imprisonment for a period not exceeding two year or to both a fine and such imprisonment."

National Treasury response: Agreed

CHAPTER XII: GENERAL PROVISIONS

Referral to Enforcement Committee

101(now 99)

As the directives issued by an exchange, depository or clearing house are usually operational requirements, we have assumed that the intention of the drafter of the Bill was to enable the Registrar to refer contraventions of a SRO's rules to the enforcement committee, and we submit that this section should be amended as follows:

> *"The registrar may, despite and in addition to taking any step he or she may take under this Act, refer any contravention of this Act and the exchange, depository or clearing house rules or directives to the enforcement committee"*

National Treasury response: The view is that the market infrastructure will enforce contraventions of its rules, but it does not have enforcement powers with regard to its directives. The section has been amended for clarity.

Business rescue

103(2)(b) (now 101)

The wording of section 103(2)(b) can be improved as this section is not automatically read with subsection 2(a). As it currently reads it states that if you read section 102(3),94),(5) and (6) you must construe all references to section 80 of the Companies Act in those sections as a reference to section 129 but that is only the case for the purpose of 2(a). We therefore suggest the following insertion:

> *"For the purpose of 2(a) any reference to section 80..."*

National Treasury response: Agreed

Curatorship of banks

The implication of the current section 104 of the FMB, which will apply to *"a regulated person that is a bank"*, is the following:

Section 104(1) provides that

> *"Despite any other law, the court may appoint a curator in terms of section 5 of the Financial Institutions (Protection of Funds) Act in respect of any regulated person."*

Section 104(2) of the FMB potentially does not further leave the Registrar of Banks with the discretion to refuse the request. The Registrar is expected to make the application for curatorship "*upon request of the registrar* (of Securities Services)". It is deeply concerning that the FMB seeks to vest power with another regulatory authority that is of systemic significance to banks. When read together with section 5(6) of the Financial Institutions (Protection of Funds) Act, 2001, which constrains the Registrar of Banks to issue instructions to a curator on market conduct matters, this vesting of authority to another regulatory authority is untenable.

Section 5(6) of the Financial Institutions (Protection of Funds) Act, 2001 (Act No.28 of 2001), whose full impact on section 104(2) will be illustrated below, provides as follows:

> *"The curator acts under the control of the registrar who made the application under sub-section (1), and may apply to that registrar* (where "registrar" refers to the Registrar of Securities Services) *for instructions with regard to any matter arising out of, or in connection with, the control and management of the business of the institution."*

The implication of this is that the Registrar of Securities Services as opposed to the Registrar of Banks will be responsible for the curatorship of banks.

In terms of the Banks Act, banks can only be placed under curatorship when the financial strength of the bank is called into question which in turn places the depositors' funds at immediate risk and can lead to a run on the bank. For these reasons, curatorship or even an indication that such is under consideration is only invoked by the Registrar of Bank as an absolute last resort and only in circumstances where a bank is faced with a financial crisis and then in accordance with a speedy and robust process provided for specifically in terms of the Banks Act in order to mitigate the risk of a run on the bank.

Our second concern in terms of section 104(2) of the FMB is that, when read with section 104(1), it contemplates a court process to bring about an outcome that is of systemic significance. Section 104(1) allows the court to invoke the procedure set out in section 5 of the Financial Institutions (Protection of Funds) Act, 2001 to appoint a curator to take control of and manage the whole or any part of the business of a regulated person.

Since the curatorship regime is designed to resolve a banking crisis without severe systemic disruption and without exposing taxpayers to loss while still protecting vital economic functions, it is necessarily a process of early intervention in which the conditions governing its application must be precise, transparent, timely and decisive. In the Banks Act, curatorship is therefore deliberately designed to go outside the formalistic court processes.

The FMB, on the other hand envisages a court process for the curatorship of banks. Should the Registrar of Securities Services pursue a writ against a delinquent bank in terms of the FMB, citing a commercial bank as a respondent in a court motion to appoint a curator is enough to provoke panic in the market, such a panic may in turn trigger a disruption in the financial system because the public will interpret such an action as a failure of the bank, causing them to lose trust in the bank and potentially spiralling into a run on the bank and a flight of capital.

Recommendations: Section 104(2) should be deleted

National Treasury response: National Treasury agrees. Section 3(1)(a) has been amended to exclude an bank from these provisions.

107

Right of Appeal

We agree with the amendments to section62 and 63. One of the concerns raised was that a more formal and vigorous **adjudication** process is required for disputes between market users and the SROs, and market users and the regulator.

National Treasury's response was that sufficient recourse mechanisms are in place for disputes of decisions taken by a SRO which include:

- the Bill provides for a strengthened consultation processes to ensure broad stakeholder participation in rulemaking by SROs
- Administrative decisions taken by an SRO are subject to appeal (section107)
- Any concern by a market user relating to an SRO can be voiced to the FSB at any time *(Practically, this does not apply and we have at least one example where a referral to the FSB was turned down on the basis that the FSB could not intervene in the matter as it was between the CSD (Strate) and a participant (us)).*

In our view section 107 is not broad enough to cover all the issues that the participants may have against the CSD. We strongly believe that there should be a committee or panel at the level of the FSB to deal with the issues that the Participant or CSD may not be able to resolve amongst themselves, including but not limited to the carrying on of additional business. This will assist the market to be in a position not to have to resort to litigation every time there is a dispute.

National Treasury response: It was agreed to impose requirement for a complaints process for exchanges, central securities depositories and independent clearing houses**.** Provision not appropriate for market infrastructures generally. Added in new 17(2)(s), 35(2)(v) and 53(2)(l).

General comments

Conflict with FAIS

In terms of the Financial Advisory and Intermediary Services Act No. 37 of 2002 ("FAIS"), Section 1

> *"financial service" means any service contemplated in paragraph (a), (b) or (c) of the definition of "financial services provider", including any category of such services;*
>
> *"financial services provider" means any person, other than a representative, who as a regular feature of the business of such person—*
>
> *(a) furnishes advice; or*
>
> *(b) furnishes advice and renders any intermediary service; or*
>
> *(c) renders an intermediary service;*

"advice" means, subject to subsection (3) (a), any recommendation, guidance or proposal of a financial nature furnished, by any means or medium, to any client or group of clients—

(a) in respect of the purchase of any financial product; or

(b) in respect of the investment in any financial product; or

(c) on the conclusion of any other transaction, including a loan or cession, aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product; or

(d) on the variation of any term or condition applying to a financial product, on the replacement of any such product, or on the termination of any purchase of or investment in any such product, and irrespective of whether or not such advice—

(i) is furnished in the course of or incidental to financial planning in connection with the affairs of the client; or

(ii) results in any such purchase, investment, transaction, variation, replacement or termination, as the case may be, being effected;

"intermediary service" means, subject to subsection (3)(b), **any act other than the furnishing of advice**, *performed by a person for or on behalf of a client or product supplier—*

(a) the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier; or

(b) with a view to—

(i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested;

(ii) collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of a financial product; or

(iii) receiving, submitting or processing the claims of a client against a product supplier;

Issue 1:

FAIS comprehensively governs the provision of advice and rendering of financial services.

The requirements of FAIS are however inappropriate for the traded markets and these would be better regulated by a specific code for securities services. This distinction is well illustrated in the JSE rules which are appropriate to the fast moving exchange traded environment.

In terms of section 45 (of the Financial Advisory and Intermediary Services Act, 2002):

"45. Exemptions, and amendment or repeal of laws.

(1) The provisions of this Act do not apply to the rendering of financial services by—

(a)

(i) any "authorised user", "clearing member", "licensed clearing house", "licensed central securities depository", or "participant" as defined in section 1 of the ***[Securities Services Act, 2002, or exchange licensed under section 10 of that Act]*** *Financial Markets Act, 2012;*

(ii) a manager as defined in section 1 of the Collective Investment Schemes Control Act, 2002;

(iii) a person performing the functions referred to in section 13B of the Pension Funds Act, 1956 (Act No. 24 of 1956), if such person complies with the requirements and conditions contemplated in that section; or

(iv) a person carrying on the business referred to in section 58 of the Medical Schemes Act, 1998 (Act No. 131 of 1998), if such person complies with the requirements contemplated in that section, to the extent that the rendering of financial services are specifically supervised under that Act"

The problem is that the definition of *"intermediary services"* in FAIS is so broad that it includes *"any act other than the furnishing of advice"*. The Financial Markets Bill responds by carving out financial services which are **specifically supervised**. The impact is that there is uncertainty is to what services are regulated under FAIS and which under the Financial Markets Bill.

Proposal

1. The substitution in section 45(1) for paragraph(a)(i) of the following:

''(i) any ''authorised user'', ''clearing member'', ''licensed clearing house'', ''licensed central securities depository'', or ''participant'' as defined in section 1 of the ***[Securities Services Act, 2002, or exchange licensed under section 10 of that Act]*** *Financial Markets Act, 2012, to the extent that the rendering of those services are* ***[specifically supervised]*** *licensed under that Act;''.*

National Treasury response: National Treasury agrees with the principle contemplated above however, we are concerned that the proposal is too broad. It is therefore proposed that the provisions be amended as follows:

"The provisions of this Act do not apply to the rendering of financial services by—

(a) (i) any "authorised user", "clearing member", "licensed clearing house", "licensed central securities depository" "licensed exchange" or "participant" as defined in section 1 of the ***[Securities Services Act, 2002, or exchange licensed under section 10 of that Act]*** *Financial Markets Act, 2012* , that is authorised by that Act to render those financial services;".

Commitment of Traders Report on Agricultural Commodity Derivates

We take note that Treasury views the FMB as a principle-based approach to legislation. That it enables a framework for further regulation around OTC derivatives and that is therefore not necessary to specifically legislate around a Commitment of Traders Report. We take note that this concern can be adequately dealt with by Ministerial regulations (S 109 of the Bill) or through FSB directives for unlisted securities (S 77). Also that speculative spot limits are set on trading certain agricultural products which should mitigate volatility on terms of listed derivatives and JSE rules (rule 10.40).

Please take note that a Commitment of Traders Report on agricultural commodities is not made available by the JSE. We are of opinion it should be made available to market participants including producers as it will support decisions to hedge efficiently.

We look forward to your comments / suggestions how to further the publication of a Commitment of Traders Report given that the regulations for this purpose are sufficient.

Impact of high frequency/ algorithm traders on Agricultural Commodity Derivatives

In your email dated 9 May 2012, you mentioned that Treasury is aware of the concerns around speculative trading and price volatility. We understand that Treasury is already engaging with the regulators of the industry and market participants on the likely impact of high frequency trading, especially as it relates to the South African markets, and how to best manage the volatility associated with the impact of excess speculative behaviour.

Grain SA is concerned that producers may find themselves at a real disadvantage to the ever more powerful high-frequency traders. Producers will not be able to digest information and formulate a strategy to better hedge their crops as the split second reaction of the “algorithm” traders and high-tech crowd will have already jumped the trade. No longer will producers be able to field calls from their advisors and develop a game plan or strategy in regards to the market numbers as it will be too late.

There is a global outcry that speculation is ruining our commodity markets and unfairly manipulating prices. We understand that currently there are still no high frequency / algorithm traders active on the agricultural futures market yet. However, there may be some participation on the agricultural options market already. It is necessary for government to determine what is best for the producer that these exchanges were originally designed to help protect. The purpose of exchanges should be to create more direct market access, liquidity and less volatility for producers. Instead it seems that competing for market share, exchange fees and higher volumes became the objective of exchanges. Care should be taken to serve the hedger and to consider the potential negative impact these trades may have on production and food security.

It is our recommendation that the Financial Markets Bill make sufficient provision to curb the activities of high frequency trades if need be in future.

National Treasury response: National Treasury notes the concerns raised. National Treasury is in the process of implementing major regulatory reforms and the Financial Markets Bill is meant to create an enabling framework. Trading activity that is the subject to the Bill will change and evolve continuously, and appropriately, the Bill extends the regulatory authority of the FSB. For instance, s5 and s6 of the Bill extend the powers of the Minister and the Registrar with respect to unlisted securities. Given the shortcomings in regulation that were exposed during the global financial crisis, such amendments enable the regulation of unlisted securities to be in line with G-20 and IOSCO recommendations. Given the technical nature of the issues brought to light regarding a *Commitment of Traders Report* and speculative activity in the Agricultural commodity derivatives space, these issues would be better captured in terms of the Ministerial regulations and FSB directives, and not the Financial Markets Bill. For instance, in terms of the JSE rules (rule 10.40); currently speculative spot limits are set on trading certain agricultural products. Further to the above, we are engaging with the regulators of the industry and market participants, on the likely impact of high frequency trading, especially as it relates to the South African financial markets, and how best to manage the volatility associated with the impact of excess speculative behaviour.

Consequential amendment to Insolvency Act on page 73-35A(1)(a) – should refer to an exchange as defined in section 1and licensed under section 8 of the FMA (not section 11).

National Treasury response: Agreed

3. ANNEXURE A: LIST OF COMMENTERS

1	Absa Capital (Anne Clayton)
2	ASISA (Adri Messerschmidt)
3	Computershare (Teresa Van Niekerk)
4	Cypress Legal (Felix Majoni)
5	Deutsche Securities (Pty) Ltd (Brett Thornton-Dibb)
6	GrainSA (Wessel Lemmer)
7	JSE Ltd (Louis Cockeran/Shaun Davies)
8	Mark Brits
9	Nathan Hittler
10	Norton Rose (Robyn Holwill/Candice Posthumus/Lynette Swart)
11	Rand Merchant Bank (Russell Humphreys)
12	South African Reserve Bank (Lesetja Kganyago)
13	Strate Ltd (Maria Vermaas)
14	The Banking Association South Africa (BASA) (Mark Brits)