

FINANCIAL MATTERS AMENDMENT BILL [B1-2019]

Briefing to Standing Committee on Finance

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national treasury

Department:
National Treasury
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Background

- Bill seeks to amend
 - Insolvency Act, 1936 by ensuring that government's international objectives for enabling over-the-counter (OTC) derivatives transactions with international counterparties (South Africa's compliance with its G-20 commitments) are met
 - Military Pensions Act, 1976 by introducing gender neutrality and recognising various forms of legal marriages for purposes of benefits for all military staff in accordance with right to equality in section 9 of Constitution
 - Banks Act, 1990 to enable qualifying state-owned companies to apply for banking licences subject to executive approval
 - Government Employees Pension Law, 1996 by introducing principle of "service reduction approach" to ensure that member's pension pay-outs to former spouses upon divorce are not converted to debt obligation as is case under current approach
 - Auditing Profession Act, 2005 to enhance regulatory powers of Independent Regulatory Board for Auditors
- Bill was published for comment on 24 August 2018 with closing date of 14 September 2018
- Bill was introduced in Parliament on 31 January 2019

1. Insolvency Act

- To amend the Insolvency Act to ensure that South Africa complies with its G-20 international obligations on exchange of margin in accordance with the 2015 BCBS-IOSCO Margin Rules Framework
- To ensure that collateral exchanged as margin is easily and readily realisable upon default of one of the counterparties to an OTC Derivatives Transaction and is immediately available to the non-defaulting counterparty
- To alleviate the conflict of laws and align the Insolvency Act with the Draft Margin Notice (to be published in 2019)
- Amendment further provides for a process to be followed when a master agreement creditor realizes his/her security in terms of the master agreement and for the Office of the Master to deal with disputes of preference under those agreements

2. Military Pensions Act

- According to section 9(1) and (3) of Constitution
 - everyone is equal before law and has right to equal protection and benefit of law
 - State may not unfairly discriminate directly or indirectly against anyone on any grounds such as gender, sex and sexual orientation
- Military Pensions Act
 - provides for, among others, pensions and gratuities for certain persons in respect of disability caused or aggravated by military services
 - recognises certain marriages and male gender for purposes of benefits in manner contrary to section 9 of Constitution e.g. section 1 defines "dependant" in relation to member, to be his wife or child. This definition assumes that members are only husbands in heterosexual relationships and furthermore perpetuates discriminatory stereotypes that only heterosexual relationship is acceptable

2. Military Pensions Act (cont..)

- Military Pensions Act disregards fact that military service comprises of both men and women who are in different types of relationships which are treated equally in terms of Constitution and recognised in other laws, such as Marriages Act, 1961 and Civil Union Act, 2006
- Bill proposes, among others, amendment of word "spouse" to include members in different types of relationships and deletion of definition of "wife" and "widow"
- To ensure gender neutrally, Bill also proposes replacing term "widow" for "spouse" and "marital state" for "spousal status"

3. Banks Act

- Under Companies Act, 2008, state-owned companies are no longer classified as public companies
- Currently, Banks Act only allows for public companies to establish a bank. As a result, state-owned companies meeting prudential and other requirements of Banks Act, are unable to apply for authorisation to establish bank
- To limit fiscal risks of state-owned banks which may, in terms of its founding legislation, be able continue to operate despite being not a going concern, it is proposed that only qualifying state-owned companies that are financially sound may apply for authorisation to establish bank
- Bill proposes that
 - state-owned company must first obtain approval of Minister of Finance, acting with concurrence of Minister responsible for state-owned company to apply for authorisation to establish bank
 - assets of company, its holding company and, if applicable, holding company of its holding company, must exceed its liabilities
- Bill limits definition of “public company” in section 1 of Companies Act by excluding enterprise owned by municipality from qualifying to register as bank

3. Banks Act (cont...)

- Major SA state banks and DFIs

Institution	Sector	Funding Model
IDC	Industrial/SMME	Wholesale/Self-Funded
SEFA (Small Enterprise Finance Agency)	SMME and BEE	Government transfer (via IDC)
NEF		Government transfers and self-funded
DBSA (Development Bank of Southern Africa)	Infrastructure	Wholesale/ Self-Funded
NHFC	Housing	Wholesale/Government transfer/ Multilateral and bi-lateral loans
NURCHA		Wholesale/ Government transfers/ Self-Funded
RHLF		Government transfer/ Self-Funded
Land Bank	Rural Development	Wholesale/ Self-Funded
Ithala	Savings/transactional	Government transfers/ Deposits
Postbank		Deposits

3. Banks Act (cont....)

Lessons from recent bank failures in SA

- **Saambou Bank**
 - placed under curatorship in September 2002 after having been managed recklessly;
 - experienced liquidity challenges and it was apparent to the Registrar of Banks that it would not be able to repay depositors.
- **African Bank**
 - placed under curatorship in August 2014 after having been managed recklessly;
 - recklessly made loans to Ellerines totalling R1.4 billion without collateral, and there was no reasonable prospect of the loans being repaid.
- **VBS Mutual Bank**
 - placed under curatorship in March 2018, on the backdrop of a severe liquidity crisis;
 - According to the investigator's report, there was systematic looting of the bank of up to R2bn at VBS Mutual Bank.

3. Banks Act (cont....)

South Africa's experience with state banks

Postbank

- The Postbank [a division of the South African Post Office (SAPO)] is currently excluded from the Banks Act (i.e. the Banks Act does not apply to it);
- In the late 1990s, SAPO used depositors' funds to finance postal operational losses;
- In the 2003/2004 Adjustment Budget, Parliament allocated an amount of R750 million to SAPO as a capital injection to enable it (through its Postbank division) to settle its liability in respect of depositor funds.

Meeg Bank

- Meeg Bank was part-owned (23.2%) by the Eastern Cape provincial government (ECPG), with ABSA Bank owning a 49.8% shareholding, and remaining stake was owned by private individuals;
- Meeg Bank experienced financial, management and corporate governance difficulties for a prolonged period;

3. Banks Act (cont...)

South Africa's experience with state banks

- The ECPG could not inject additional capital (in proportion to its shareholding the bank) to comply with minimum capital adequacy requirements;
- The ECPG subsequently relinquished its shareholding in 2009.

Ithala

- Ithala (a wholly-owned subsidiary of the Ithala Development Finance Corporation), operates under exemption from the Banks Act;
- The KZN provincial government has provided financial support to Ithala totalling R340.7 million since 2013;
- The financial support provided to Ithala is mainly due to Ithala not being able to contain its cost (when measured against its revenue streams);
- Ithala submitted an application to establish a bank in November 2016;
- In 2017, the then Registrar of Banks declined the application as it was of the view, at the time, that Ithala could not successfully establish itself as a bank.

3 Banks Act (cont...)

Governance conflicts presented by state banks

- International experience, and South Africa's own experience suggests that state ownership of banks has potential to undermine prompt corrective action by prudential regulators;
- Prudential regulators sometimes forbear (i.e. they do not apply full regulatory measures) when faced with failing state banks due to the reluctance to frustrate what could be viewed as government policy or programs;
- This is undesirable as the prudential regulators are duty-bound to level the playing field;
- Prudential regulators must maintain an environment in which all entities operating in the banking sector adhere to the same principles in order to be supervised effectively;
- When Meeg Bank experienced difficulties, government felt at the time that state ownership (national, provincial or local) of banks was undesirable as it could create governance conflicts and undermine effective and uniform regulation and supervision by the prudential regulator.

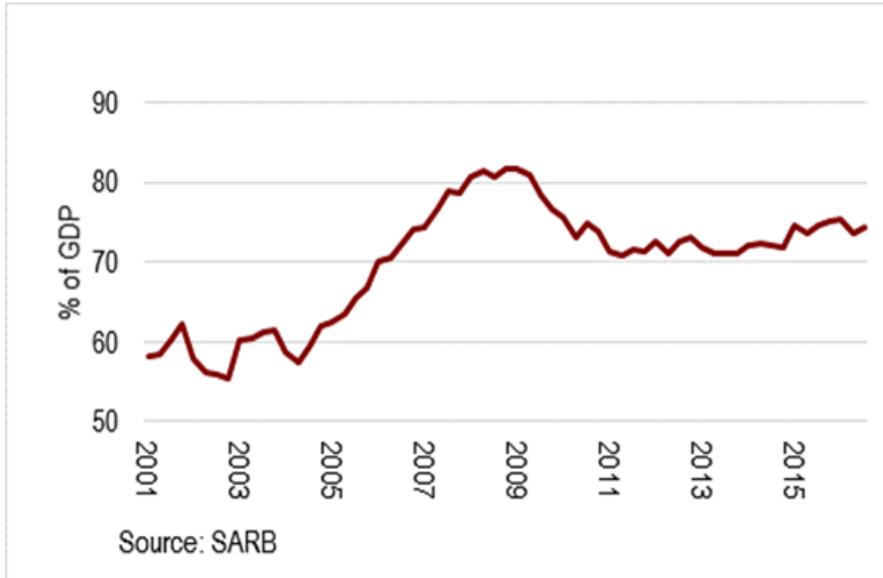
3. Banks Act (cont...)

Rationale for establishing state banks and market failure

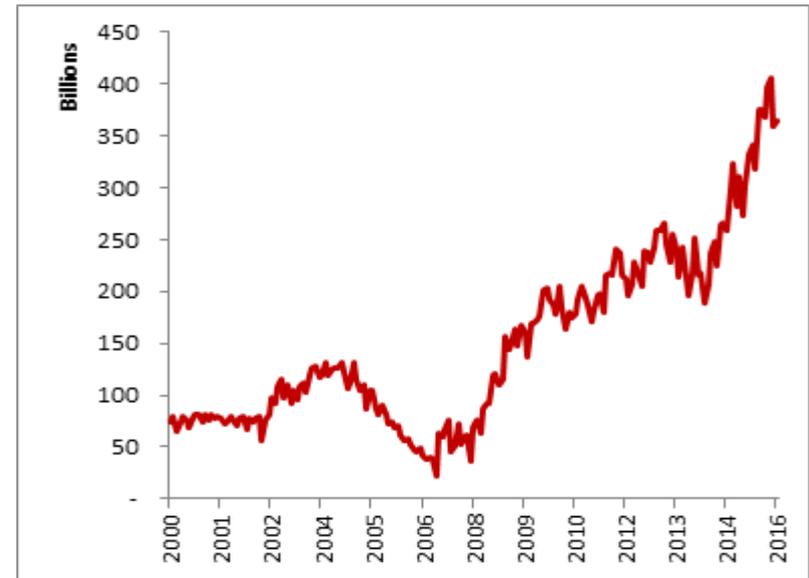
- The traditional rationale for introducing a state bank relates to addressing market failures, i.e. the state supplying services that privately-owned banks may be unable or unwilling to supply;
- However, in a market where failures do not exist, introducing state banks is harder to justify;
- The ownership of banks by the state represents a huge contingent liability on the shareholder (in this case ultimately the fiscus). Currently the contingent liability is circa R7 billion;
- Financial inclusion is often cited as the key reason for the establishment of state-owned retail banks;
- However, South Africa has made progress in improving retail financial inclusion, with 90% of South African adults using some form of financial service (FinScope, 2018), and of which less than 1% is attributable to the Postbank.

Commercial and State banking: The good and bad

Total private sector credit by commercial banks



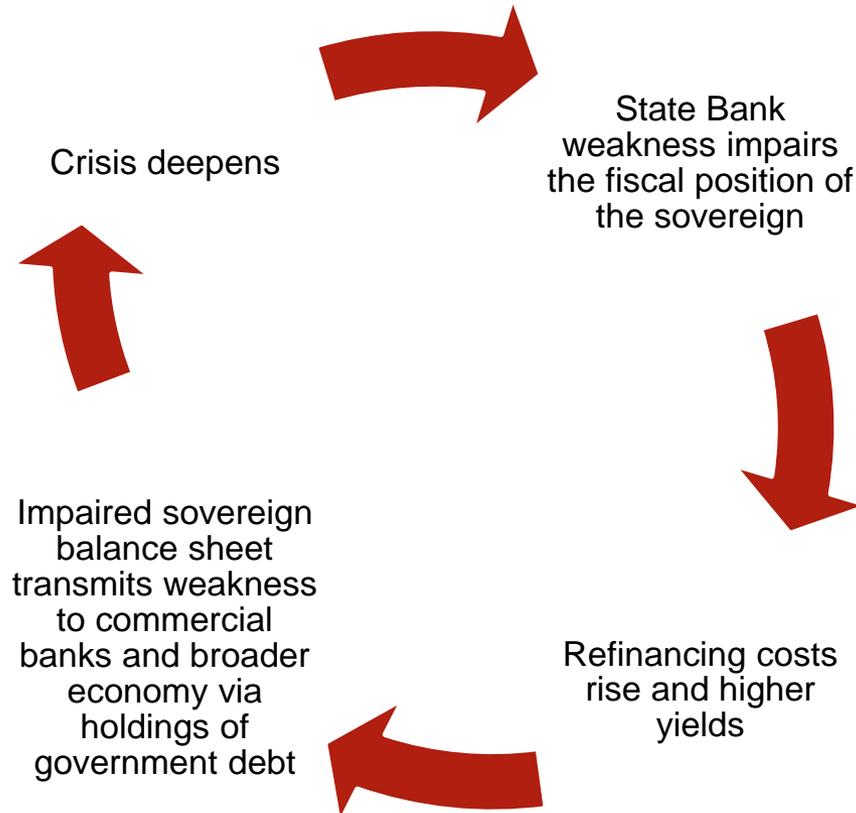
Commercial Banks exposure to government (loans and bonds)



- Commercial banks support of government has increased dramatically since the financial crisis;
- The South African commercial banking sector is increasingly oriented to the programme of government;
- However, this increased orientation may have crowding out effects.

State banks pose significant fiscal risks

The root of the problems currently faced by many advanced economies is caused by the close interrelationship between banks and the sovereign. This risk is particularly acute for a state bank



4. Government Employees Pension Law

- GEP Law regulates Government Employee Pension Fund (GEPF)
- Non-member spouses of GEPF members
 - were denied their share of pension benefit immediately upon divorce or dissolution of customary marriage and
 - had to wait until their member former spouses became entitled to their own benefit
- Pension Funds Act, 1956 entitled non-members spouses to their pension interest in funds, governed by that Act, **upon** divorce or dissolution of customary marriage, so-called “clean-break principle”
- In *Wiese v GEPF* matter, Court declared
 - GEP Law inconsistent with section 9(1) of Constitution in so far as it fails to afford former spouses of GEPF members same rights and advantages as are afforded to former spouses of members of funds under Pension Funds Act

4. Government Employees Pension Law (cont...)

- To implement Court's order, Parliament amended GEP Law in 2011 by inserting section 24A to provide for "clean-break principle"
- Portion of member's pension interest assigned to non-member spouse is deemed to accrue as debt to member on date on which decree of divorce or for dissolution of customary marriage is granted
- Amount paid to non-member spouse in giving effect to clean-break principle is regarded by GEPF rules as debt due by member ("the divorce debt approach") to GEPF
- Rules of GEPF (rule 14.10.9) require that divorce debt be created at time member divorces or at dissolution of customary marriage in respect of amount paid to former spouse
- Members have opportunity to settle portion or full debt over period of membership should they so wish, but if unsettled amount remains at time member exits GEPF, debt is deducted from benefit payable

4. Government Employees Pension Law (cont)

- On retirement of member, in terms of current GEPF rules, divorce debt is offset against member's gratuity entitlement
- Should gratuity be less than outstanding divorce debt, balance of debt is recovered by reduction in annual pension. Then member will retire and not receive any cash on retirement
- Divorce debt approach subject to High Court application: *Crafford v GEPF* applicant claiming:
 - divorce debt approach, which results in a "forced loan" infringes upon constitutional rights to equality and social security
 - this approach imposes unjustifiable burden on members of GEPF
- To address prejudice to members the Bill proposes replacement of debt approach with reduction of member's year of pensionable service ("the service reduction approach")
- Bill has transitional measure allowing members whose amount of pension benefit is subject to reduction because of debt approach (immediately prior to amendment), to choose whether divorce debt approach **or** service reduction approach must be applied to benefit

5. Auditing Profession Act

- Auditing Profession Act provides for establishment of Independent Regulatory Board for Auditors (“IRBA”) and regulation of conduct of registered auditors and candidate auditors
- Section 4 of Act provides for general functions of IRBA and requires IRBA to take steps to promote integrity of auditing profession by, among others, investigating alleged improper conduct, conducting disciplinary hearings and imposing sanctions for improper conduct

5. Auditing Profession Act (cont..)

- To strengthen IRBA's independence, address conflict of interest of board members, prohibit registered auditors and candidate auditors from being appointed as board members and prohibit board members from
 - sharing directly or indirectly, in profits of registered auditor or candidate auditor
 - receiving payments from registered auditor or candidate auditor
- To address challenges faced by IRBA during investigations into improper conduct by registered auditors, Bill—
 - allows IRBA to establish subcommittees, including enforcement committee to deal certain categories of disciplinary matters
 - provides for power for investigating committee to authorise official of IRBA to enter and search premises or subpoena any person with information required to complete investigation

5. Auditing Profession Act (cont..)

- To lessen burden on disciplinary committee to deal with cases, enabling IRBA to appoint as many members of disciplinary committee as it may determine
 - Then for each disciplinary case, panel must be appointed
- Bill provides process to be followed after investigation and sanctions to be imposed following admission of guilt or disciplinary process
 - Sanctions which may be imposed include, caution or reprimand, fine, cancellation of registration, disqualification from registration as auditor
- Proposed amendments also empower IRBA to, if considered appropriate, refer matter against registered auditor to accredited professional body for investigation
- Bill requires IRBA to take appropriate measures in respect of personal information in its possession or under its control

Amendments from public comments

Insolvency Act

- Reference to collateral security held in terms of a Master Agreement in S35B(2) in conflict with pledged assets provided in 83(10), latter speaks to outright transfer of ownership whilst former speaks to pledging for security purposes – Clauses 83(5),83(10),(10A)(a)
- Standards can be issued in terms of the Financial Markets Act – Clauses 83(5),83(10),(10A)(a)
- Proof of claim alignment with s44(4) of Insolvency Act – C(10A)(a)(i)
- Alignment with S83(12) of Insolvency Act – Clause (10A)(a)(iii)
- Deletion of “creditors interested in the estate” – Clause (10B)(a)
- Administrative Powers of Master – Clause (10B)(e) aligned with S111(2)
- Alignment with S89(2) of secured creditor liability for costs of sequestration – Clause (10B)(f)

Amendments from public comments

Military Pensions Act

- Clause 7- amendment of section 11
 - substitution of “marital state” for “spousal status” to ensure gender neutrality

Banks Act

- Clause 10- amendment of section 1
 - definition of “public company” amended for clarity purposes by making reference to ‘state-owned company’ as defined in paragraph (a) of the definition of “state-owned company” in section 1 of the Companies Act. This is to ensure that enterprise owned by municipality may not be registered as bank
- Clause 11- amendment of section 12
 - subsection 4(a) inserted to state that subsection only applies to a state-owned company as defined in paragraph (a) of definition of “state-owned company” in section 1 of Companies Act

Amendments from public comments

Government Employees Pension Law

- No amendments

Auditing Profession Act

- Clause 15- amendment of section 11- Appointment of members of Regulatory Board
 - 11(2)- Minister to appoint persons who are independent of the auditing profession
 - 11(2A) inserted- Two persons appointed to the Board to include a person who was a registered auditor with at least 10 years' experience in auditing and an advocate or attorney with at least 10 years' experience in practicing law.
- Clause 17- insertion of section 17A- Subcommittees of Regulatory Board
 - Provides for Board to establish enforcement committee to deal with disciplinary matters, another power for Board to establish other subcommittees to assist with performance of its functions
 - Members of subcommittees to be appointed from among members of Board

Amendments from public comments

Auditing Profession Act

- Clause 18-amendment of section 20
 - words “as and when it is required” substituted to provide for committees of Board to meet at least twice a year
- Clause 19 (amendment of section 24- Investigating committee)
 - Clause amended to only provide for matters dealing with investigating committee
 - Matters relating to disciplinary moved to another clause
- Clause 20 - insertion of sections 24A to 24C
 - 24A provides for powers for investigating committee to enter and search premises
 - 24B regulates use of warrant during search
 - 24C provides for establishment of disciplinary committee to conduct disciplinary hearings

Amendments from public comments

Auditing Profession Act

- Clause 21- insertion of section 37(1A)
 - to provide for registration with Board if individual is member of accredited professional body
- Clause 22- section 45(7)
 - rephrased to provide more clarity on removal of auditor after reporting irregularity to Board
- Clause 23- insertion of section 48(1A)
 - replacing regulatory Board with enforcement committee and giving committee power to refer non-audit matter brought against auditor to accredited professional body for investigation and disciplinary proceedings

Amendments from public comments

Auditing Profession Act

- Clause 24- substitutions of section 49 to 51
 - section 49 deals with process following investigation
 - section 50 deals with disciplinary hearing
 - section 50A deals with disclosure of information
 - section 51 provides for sanctions in admission of guilt process
- Clause 26- amendment of section 51B by providing for sanctions in disciplinary hearing process
- Clause 27- substitution of section 53 to provide for offences relating to investigation and disciplinary process

***Ro livhuwa/ Thank you/Re a
leboga/ Dankie***