ALLEN & OVERY(SOUTH AFRICA) LLP

**Comments on the draft Financial Matters Amendment Bill of 2019**

8 February 2019

# GENERAL COMMENTS

1. Allen & Overy (South Africa) LLP welcomes the opportunity to provide comments on the draft Financial Matters Amendment Bill of 2019 (the **Bill**) published for comment on 16 January 2019.
2. We set out below our main comments:
	1. The Bill provides for the insertion of subsections 10A and 10B of section 83 of the Insolvency Act, 1936 (**Insolvency Act**) which provides that a secured party may retain the proceeds of the realisation of secured property for the settlement of a secured claim arising out of a “master agreement” as defined in section 35B of the Insolvency Act. The secured party is required to notify the trustee or the Master of the proceeds of the realisation of collateral and confirm the terms of the relevant master agreement, the nature of the claim, the nature and particulars of the realised security and the calculation of the net amount. Subsection 10B provides further that a creditor or a trustee may object to the realisation of the collateral after which a defined dispute resolution procedure must be followed as a consequence of which the Master may determine that objection is well founded in which case the secured creditor must pay over the realisation proceeds plus interest to the Master. Only after the secured creditor has paid over these realisation proceeds may the secured creditor then challenge such decision in court.
	2. The Final Draft Joint Standard on Margin Requirements for Non-Centrally Cleared OTC Derivative Transactions published in August 2018 (the **Draft Margin Joint Standard**) in section 4.3(2) provides that a “Initial margin must be held in such a manner that it is available to the person who collected the initial margin in the event of the counterparty’s default.” Section 6 titled ‘*Eligible collateral*’ provides that a covered entity must have in place processes, procedures and board-approved policies to ensure that assets collected as collateral for purposes of initial or variation margin may be liquidated in time to generate proceeds to protect covered parties.
	3. Furthermore in terms of the requirements under the European Market Infrastructure Regulation (**EMIR Regulations**) counterparties are prohibited from using assets classes referred to in Article 4(1) of the Technical Supplement published on 4 October 2016 as collateral where they have no access to the market for those assets or where they are unable to liquidate those assets in a timely manner in case of default of the posting counterparty.
	4. While the proposed amendments in subsections 10A and 10B of section 83 of the Insolvency Act are welcomed, the addition of the dispute resolution procedure that must be undertaken should an objection be raised by the trustee or a creditor will not satisfy the timely realization requirements in either the Draft Margin Joint Standard or the EMIR Regulationsas the secured creditor will be required to pay over the realization proceeds. This will mean that parties that are required to post margin pursuant to an OTC derivative transaction will not be able to post securities that would be subject to section 83 of the Insolvency Act as there securities will not be considered as eligible collateral.
	5. This will impact not only local entities that are required to margin but also from a cross-border perspective, foreign counterparties will not accept as collateral from South African counterparties securities subject to section 83 of the Insolvency Act.

# SPECIFIC COMMENTS

We set out below our specific comments on the various sections.

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| **Item** | **Proposed amendment** | **Comment** |
| **Amendments to the Insolvency Act, 1936** |
| 1 | Amendment of Section 83 – *“(a)* by the substitution for subsection (5) of the following subsection:‘‘(5) The creditor shall, as soon as possible after he has realized such property, other than the property held as security in favour of a secured creditor for obligations arising out of a master agreement defined in section 35B(2) (including eligible collateral in terms of the applicable standards made under the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017), or the Financial Markets Act, 2012 (Act No. 19 of 2012)), prove in terms of section **[forty-four]** 44 the claim thereby secured andhe shall attach to the affidavit submitted in proof of his claim a statement of the proceeds of the realization and of the facts on which he relies for his preference.’’;*(b)* by the substitution for subsection (10) of the following subsection:‘‘(10) Whenever a creditor has realized his security, other than the property held as security in favour of a secured creditor for obligations arising out of a master agreement defined in section 35B(2) (including eligible collateral in terms of the applicable standards made under theFinancial Sector Regulation Act, 2017 (Act No. 9 of 2017), or the Financial Markets Act, 2012 (Act No. 19 of 2012)), as hereinbefore provided, he shall forthwith pay the net proceeds of the realization to the trustee, or if there is no trustee, to the Master and thereafter the creditorshall be entitled to payment, out of such proceeds, of his preferment claim if such claim was proved and admitted as provided by section**[forty-four]** 44 and the trustee or the Master is satisfied that the claim was in fact secured by the property so realized. If the trustee disputes thepreference, the creditor may either lay before the Master an objection under section **[one hundred and eleven]** 111 to the trustee’s account, or apply to court, after notice or motion to the trustee, for an order compelling the trustee to pay him forthwith. Upon such application the court may make such order as to it seems just.’’; and*(c)* by the insertion after subsection (10) of the following subsections:‘‘(10A) *(a)* Whenever a creditor has realized property held as security in respect of claims arising out of a master agreement defined in section 35B(2) (including eligible collateral in terms of the applicable standardsunder the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017), or the Financial Markets Act, 2012 (Act No. 19 of 2012)), such creditor may retain the proceeds of the realization for the settlement of thesecured claim and must as soon as possible after realization—(i) give written notice of that fact to the trustee or the Master and provide the trustee or the Master with a signed and authenticated copy of the master agreement and an affidavit confirming—*(aa)* that the master agreement had been entered into;*(bb)* the nature and particulars of the claim; and*(cc)* the nature and particulars of the realized security, includingthe net amount calculated at the date of sequestration as proof of the secured claim;(ii) if the net proceeds of the realization exceed the value of the claim, pay to the trustee or the Master the balance, after payment of those claims, and such amount shall be added to the free residue of the estate in question; and(iii) if the net proceeds of the realization are less than the value of the claim, the creditor shall be entitled to rank against the estate in respect of the excess as an unsecured creditor.*(b)* Upon receipt of the notice submitted under subsection (10A)*(a)*(i), the trustee or the Master shall notify all creditors at the second meeting of creditors of the realization of the collateral security and inform them of their right to lodge an objection.(10B) *(a)* The trustee or any other creditor may dispute the preference in writing to the Master and shall provide reasons therefor by no later than 14 days of the second meeting of creditors.*(b)* The Master must immediately notify the creditor that has realized the property held as security under a master agreement as contemplated in subsection (10A) of the dispute.*(c)* The creditor that has realized the property may lay before the Master an objection and response to the dispute of the preference within 14 days of receipt of the notification contemplated in paragraph *(b)*.*(d)* The Master must make a determination on the dispute of the preference within 21 days of receipt of such objection and may request any material information from the parties to be furnished in connection with the dispute.*(e)* If the Master is of the opinion that the dispute of the preference in terms of subsection (10B)*(a)* is well founded, the creditor must immediately pay the net proceeds, including any accruing interest, of the realization of the security to the trustee, and the creditor may thereafterapply to court, after notice of motion to the trustee and the Master, for an order to set aside the Master’s decision, and the court may upon such application make any order as to it seems just.*(f)* The creditor that has realized the property held in terms of subsection (10A)*(a)*, whether or not the creditor has proved a claim against the estate in terms of subsection (10A)*(a)*(i), shall be liable to contribute not less than what the creditor would have had to contribute if such creditor had proved the claim, provided that where the secured creditor relies for the satisfaction of his claim solely on the proceeds of the property which constitutes his security, he shall not be liable for any costs of sequestration other than the costs specified in section 89(1) and costs for which he may be liable under paragraph *(a)* or *(b)* of the provisoto section 106.’’. |

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| We suggest that this wording be deleted as follows for the reasons set out above: “10B) *(a)* The trustee or any other creditor may dispute the preference in writing to the Master and shall provide reasons therefor by no later than 14 days of the second meeting of creditors.*(b)* The Master must immediately notify the creditor that has realized the property held as security under a master agreement as contemplated in subsection (10A) of the dispute.*(c)* The creditor that has realized the property may lay before the Master an objection and response to the dispute of the preference within 14 days of receipt of the notification contemplated in paragraph *(b)*.*(d)* The Master must make a determination on the dispute of the preference within 21 days of receipt of such objection and may request any material information from the parties to be furnished in connection with the dispute.*(e)* If the Master is of the opinion that the dispute of the preference in terms of subsection (10B)*(a)* is well founded, the creditor must immediately pay the net proceeds, including any accruing interest, of the realization of the security to the trustee, and the creditor may thereafterapply to court, after notice of motion to the trustee and the Master, for an order to set aside the Master’s decision, and the court may upon such application make any order as to it seems just.”   |

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We trust you find the above of assistance. We would be happy to discuss our comments or provide clarity on any of our comments should you consider it useful to do so.

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