national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

FINANCIAL SECTOR LAWS AMENDMENT BILL [B15B-2020]

Draft Response Matrix to issues raised during the Public Hearings of the Select Committee on Finance

30 NOVEMBER 2021

LIST OF COMMENTATOR(S)

NAME
Association of Black Securities and Investment Professionals (ABSIP)
Banking Association of South Africa (BASA)
Congress of South African Trade Unions (COSATU)
Free Market Foundation (FMF)

Financial Sector Laws Amendment Bill [B15B-2020]			
General Comments			
Commentator	**Clause**	**Comment/s**	**Response**
ABSIP		The Resolution Authority needs to ensure that no-creditor is "worse-off". The deviation from this should be safeguarded to ensure that all creditors are protected. The South African credit hierarchy needs to explicitly provide the distinction between customers making use of a bank daily transactions, depositors and investors. This is to safeguard all creditors the designated institution.	The Bill contains various protections for creditors e.g. the 'no creditor worse of rule' in clause 166V, that the Reserve Bank must not take a resolution action if the result of the action would result in the value of the claim of a creditor being reduced and that when taking resolution action in relation to a designated institution in resolution, the Reserve Bank must treat claims of creditors that would have the same ranking in insolvency, equally – see clause 166U.
COSATU		COSATU proposes that Parliament will amend the provisions ranking creditors. It is not acceptable or moral for pensioners and workers to be left waiting for months and often years to access what is left of their meagre savings. Workers and pensioners should not have to wait to receive what is dues to them from what is left once secured creditors have had their fill. Parliament should not wait for another bill to come in 5 years or longer. It should exercise its full Constitutional powers and amend the Bill now. This will further extend the progressive provisions of the Bill and ensure that pensioners and workers are properly protected in future.	Treasury notes the concern about protecting workers' wages and benefits. National Treasury is guided by the approach in the Insolvency Act, 1936 (Act No. 24 of 1936), administered by the Minister of Justice. In engaging with the Justice department, we have been informed that it is reviewing the Act in an integrated and holistic manner. Section 98A of the Insolvency Act provides some

			protection of wages and benefits as follows: 98A. Salaries or wages of former employees of insolvent. — (1) Thereafter any balance of the free residue shall be applied in paying— (a)to any employee who was employed by the insolvent— (i) any salary or wages, for a period not exceeding three months, due to an employee; (ii) any payment in respect of any period of leave or holiday due to the employee which has accrued as a result of his or her employment by the insolvent in the year of insolvency or the previous year, whether or not payment thereof is due at the date of sequestration; (iii) any payment due in respect of any other form of paid absence for a period not exceeding three months prior to the date of the sequestration of the estate; and (iv) any severance or retrenchment pay due to the employee in terms of any law, agreement, contract, wage-regulating

			measure, or as a result of termination in terms of section 38; and (b) any contributions which were payable by the insolvent, including contributions which were payable in respect of any of his or her employees, and which were, immediately prior to the sequestration of the estate, owing by the insolvent, in his or her capacity as employer, to any pension, provident, medical aid, sick pay, holiday, unemployment or training scheme or fund, or to any similar scheme or fund. It is acknowledged that this is subject to the insolvency process, but it is submitted that is also a matter that would also be relevant to consider and potentially be addressed in the Insolvency Act or successor legislation, and it would not be a matter that is beyond the appropriate scope of this legislation to address.
FMF		**Obstacles to resolvability remain; market appetite for *flac*; when will Bill commence?** A June 2020 evaluation by the Financial Stability Board of the effects of the too-big-to-fail reforms tentatively concludes that (while the reforms have made banks more resilient and resolvable, benefits of the reforms outweigh their costs, and indicators of systemic risk and moral hazard have "moved in the right direction"), obstacles to the resolvability of systemically-important banks remain: Improvements could be made to implementations of loss-	Details related to FLAC will be addressed in accompanying standards and not the primary law. In this regard the SARB has published a consultation paper available on the SARB website. The Bill will come

		absorbing-capacity instruments, resolution funding mechanisms, valuation of bank assets in resolution, operational continuity and continuity of access to financial-market infrastructure. State support for failing banks has continued.123 A December 2020 analysis for the World Bank about the market appetite in South Africa for *flac* instruments at this stage was inconclusive about take-up prospects.124 The Bill states that it will come into effect after enactment on a date to be determined by the Minister.125	into effect on a date to be determine by the Minister.
Definitions			
FMF		**"Resolution" is not clearly defined** • Bill *[cl 35]* will insert in the Act an **unhelpful definition of "resolution"**: Resolution means **management of the affairs** of a designated institution as **provided for in Chapter 12A** • **Chapter 12A has 60 sections** (166A-166Z, 166AA-166AZ, 166BA-166BH) • Chapter 12A **nowhere crisply says what resolution is** **What "Resolution" means is not accessible or clear** • The Bill inserts *[cl 60]* in the Act's *Long title* that its resolution framework is to ensure that **impacts** or potential **impact[s?]** on financial stability of failure of a designated institution are **managed appropriately** • This is not clear enough. It's **Vague** and so violates the **Rule of Law** • The **Rule of Law** is a **founding value** of the Republic *[Constitution, 1996 s 1(a)]* • A Rule of Law principle is that **laws should be accessible and clear** **Memorandum on Bill's objects describes Resolution**	"Resolution means management of the affairs of a designated institution as provided for in Chapter 12A " This means that the Reserve Bank, once an institution is designated as being in resolution, may manage the affairs of the institution, in accordance with the requirements and procedures provided for in Chapter 12A, and it may implement resolution actions as provided for in section 166S. It is helpful to read and understand this definition in conjunction with the following definition:

		• The Memo says— Resolution is **a process** in which a Resolution Authority takes over control and management of the affairs of a bank that is failing or likely to fail, in order **to restructure** or resolve **that bank** with the use of resolution tools **in a manner that seeks to protect financial stability and minimise the reliance on public funds** *[Memorandum on objects of the Bill, para 2.2]* • The Bill does not say it.	'' 'orderly resolution of a designated institution' means the management of the affairs of the designated institution as provided in Chapter 12A in a way that— (a) assists in maintaining financial stability; (b) ensures that the critical functions performed by the designated institution continue to be performed; and (c) in the case of a bank, protects the interests of depositors;''; The process of resolution must, therefore be applied in a manner that achieves the objectives set out in that definition. This is explained in the Memorandum on the Objects of the Bill as follows: Resolution is a process in which a Resolution Authority takes over control and management of the affairs of a bank that is failing or likely to fail, in order to restructure or resolve that bank with the use of resolution tools in a manner that

			seeks to protect financial stability and minimise the reliance on public funds It is submitted that the definition of "resolution" is appropriate for the context of the Bill, when applied as intended in the context of the "orderly resolution of a designated institution", and that it should not be necessary to amend the definition in the Bill. management of the affairs of the designated institution as provided in Chapter 12A in a way that— *(a)* assists in maintaining financial stability; *(b)* ensures that the critical functions performed by the designated institution continue to be performed; and *(c)* in the case of a bank, protects the interests of depositors;''; The process of resolution must, therefore be applied in a manner that achieves the objectives set out in that definition. This is

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Clause 51			
BASA	**166S**	We thank the NCOP Select Committee on Finance for calling for comment on the Financial Sector Laws Amendment Bill (FSLAB). We understand that this is based on the passing of the Bill by the National Assembly and referral to the NCOP for concurrence. We also understand that the Select Committee on Finance had received a briefing from National Treasury on the Bill in June 2021. While reviewing the FSLAB we have unfortunately picked up what we consider to be a drafting oversight that was not immediately obvious. We do not believe that	It is important to note that whilst certain bank curatorship provisions in the Banks Act may share similar traits with certain resolution provisions, the two processes are not the same and cannot be considered like for like e.g. the scope of curatorship is narrow and focuses on one institution whereas the scope of resolution is broader

		this issue means that the legislator differs from a substantive point of view and instead consider the issue to be relatively easily rectifiable. The issue at hand concerns the proposed introduction of sections 166S(7) and (9) of the Financial Sector Regulation Act 2017 ("FSRA") which grant the Reserve Bank resolution powers to reduce the amount payable under an agreement (section 166S(7)(a)) or cancel an agreement (section 166S(7)(b)). Section 166S(9) carve outs from the Reserve Bank's powers for the following types of agreements: (a) an unsettled exchange traded transaction; (b) a derivative instrument (as defined in the Financial Markets Act 2012 ("FMA"); (c) a deposit where the deposit holder is the Corporation for Public Deposits; (d) an unsecured transaction between two or more settlement system participants as defined in the National Payment System Act. Unfortunately, we are of the opinion that the above carve outs do not cover Securities Financing and repurchase agreements ("Prime Finance Agreements") as such agreements clearly do not fall within carve outs (a), (c) and (d). Further, it is strongly arguable that such agreements do not fall within the definition of a "derivative instrument" in the FMA (carve out (b)). For ease of reference, we set out below the definition of a "***derivative instrument***": "derivative instrument" means any - (a) financial instrument; or (b) contract, that creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate, or index, on a measure of economic value or on a default event;"	and focuses on the stability of the entire financial system, curatorship has limited powers assigned to a curator whereas resolution envisages a broad set of powers including 'bail-in' that vest in the Reserve Bank as the Resolution Authority. Similarly, resolution (or curatorship for that matter) is not the same as insolvency. The protections in the insolvency framework for holders and creditors of certain financial instruments (derivatives in terms of a master agreement or certain securities finance transactions in term of a securities lending agreement and the like) have to be considered from the view of the policy intention of each distinct framework. National Treasury and the Reserve Bank are committed to ensuring that South African financial sector laws are aligned with other international jurisdictions given the financial stability mandate of the Reserve Bank The submission from BASA is under consideration and possibly resolvable

		In our opinion, the rights and obligations arising under Prime Finance Agreements do not depend on the value of underlying assets, rates, indices or measures of economic value or a default event. Prime Finance Agreements document shadow banking products which are treated differently by regulators from derivatives. Based on our interpretation of the definition of a "derivative instrument", the result is that there is therefore effectively no carve out for Prime Finance Agreements if proposed section 166S(9) is not amended. Section 68(6B) of the current Banks Act 1990 specifically provides that section 35B of the Insolvency Act, 1936 ("**Insolvency Act**") applies to the curator of a bank under curatorship. Section 35B(2) of the Insolvency Act provides for the netting of a "master agreement" which is broadly defined in section 35B(2) as "an agreement in accordance with standard terms published by the International Swaps and Derivatives Association, the International Securities Lenders Association, the Bond Market Association or the International Securities Market Association, or any similar agreement, which provides that, upon the sequestration of one of the parties all unperformed obligations of the parties in terms of the agreement" can be netted. Section 35B of the Insolvency Act is a key section which facilitates derivatives and prime finance type trading activities amongst local banks and between local banks and foreign counterparties. Banks derive capital relief for collateralised transactions documented under a master agreement which enable the parties to effect post-insolvency netting. In the circumstances, we would recommend that section 166S(9) should read as follows: "166S(9) Subsection (7) does not apply to the following: (a) An unsettled exchange traded transaction, including a transaction on a licenced exchange;	outside of the ambit of the primary legislation. The National Treasury and the Reserve Bank met with BASA as directed by the Committee. National Treasury will publish a draft preliminary Standard, on the termination rights of agreements, in the form of a discussion document. Such publication will address the concern raised by BASA.

		(b) a derivative instrument a "master agreement" as defined in section 35B of the Insolvency Act1 of the Financial Markets Act; (c) a deposit where the deposit holder is the Corporation for Public Deposits established by section 2 of the Corporation for Public Deposits Act, 1984 (Act No. 46 of 1984); (d) an unsecured transaction between two or more settlement system participants as defined in section 1 of the National Payment System Act, made for the purposes of that Act." We also wish to state that following on from our previous submission, BASA has been in further discussions with National Treasury regarding the impact of changes to the Insolvency Act as a part of the South African Resolution Regime as per the FSLAB. We have provided National Treasury with recommendations and National Treasury are considering these recommendations that would not necessitate any changes to the FSLAB, as we understand. We remain confident that National Treasury will resolve this matter and the matter raised above, prior to the promulgation of the FSLAB into law. For information purposes, I have included our correspondence with National Treasury as **Annexure A**. Always assuring you of our best attention.	
FMF		**Reserve Bank can recommend resolution if in Reserve Bank's "opinion" a bank will "likely" be unable to meet obligations** • The Reserve Bank can recommend that the Minister place a bank in resolution if **"in the Reserve Bank's opinion"** that bank **will "likely" be unable** to meet its obligations *[Chap 12A s 166J(1), (2)]* • This gives the Reserve Bank a subjective discretion in its "opinion" a bank will "likely" be unable to meet obligations	This is the nature of prudential regulation, where the regulator has to make an assessment based on its own analysis. Such a recommendation is a judgement call based on evidence, and cannot be regarded as merely a "subjective" assessment.. Even then, the regulator can

		• This subjectivity violates the Rule of Law	only make a recommendation to the Minister in relation to whether it would be appropriate to place a bank in resolution. It therefore does not constitute an administrative decision, and therefore the rule of law is not violated by making a recommendation to the Minister. The Minister would still need to consider the recommendation, and such recommendation has to be substantiated by facts that there is some likelihood that the bank will be unable to meet its obligations. The Minister would make a decision regarding whether or not to place a bank into resolution based on that recommendation, and the evidence supporting the recommendation, and applying his or her own mind to the decision. There necessarily has to be some degree of discretion exercised in relation to an administrative decision, and it is not possible for a decision to be made to be entirely "objective".

			The proposal is not accepted, as it does not take account of how banks are regulated globally, and differently, from other sectors of the economy, given that banking is based on trust and subject to a run on the bank.
FMF	**166J**	**Reserve Bank can recommend resolution if in Reserve Bank's "opinion" a bank will "likely" be unable to meet obligations** • The Reserve Bank can recommend that the Minister place a bank in resolution if **"in the Reserve Bank's opinion"** that bank **will "likely" be unable** to meet its obligations *[Chap 12A s 166J(1), (2)]* • This gives the Reserve Bank a subjective discretion in its "opinion" a bank will "likely" be unable to meet obligations • This subjectivity violates the Rule of Law	For the reasons outlined above, this proposal is not accepted, as it does not take account of the banks are regulated globally.
FMF	**166R**	**Reserve Bank can cancel "unreasonably onerous" contracts** • **The Bill says the Reserve Bank can cancel contracts by a bank in resolution if they are "unreasonably onerous"** ***[Chap 12A s 166R(1)(a) and (2)(b)]*** • **It is unclear when a contract is "unreasonably onerous"** • **The clause is vague and violates the Rule of Law**	It is submitted that in contract law, the meaning of an onerous contract is quite well understood, and Black's Law Dictionary defines the terms as follows: "onerous - A contract, lease, share, or other right is said to be "onerous" when the obligations attaching to it unreasonably counterbalance or exceed the advantage to be derived from it, either absolutely or with reference to the particular possessor. Unreasonably burdensome or one-sided.

			It is also submitted that the term is not "vague", but that the term is sufficiently clear, and is capable of meaningful construction using the "reasonable person" test, which is another test that is applied for vagueness.