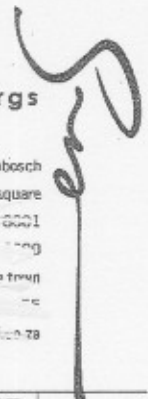


2010-23/2010]

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our ref
your ref

Mr. A Hermans, Committee Secretary
Portfolio Committee on Trade and Industry
Box 15
Parliament
Cape Town 8000

26 November 2010

Dear Mr. Hermans,

RE: COMMENT IN RESPECT OF AMENDMENT TO SECTION 136 OF COMPANIES ACT, NO 71 OF 2008 (ITEM 83 OF COMPANIES AMENDMENT BILL, NO 40 OF 2010) ON BEHALF OF THE SOUTH AFRICAN SECURITIES LENDING ASSOCIATION

Executive Summary

1. We have been mandated by the South African Securities Lending Association ("SASLA") to submit, on SASLA's behalf, certain comments to the Companies Amendment Bill, No. 40 of 2010 (the "Amendment Bill").
2. Specifically, the proposed amendment to section 136(2) of the Companies Act, No. 71 of 2008 (the "New Act", as would be amended by the Amendment Bill, the "Amended Act") in item 83 of the Amendment Bill, fails to protect certain types of agreements, including the Global Master Securities Lending Agreement (the "GMSLA"), from cancellation by a business rescue practitioner's application to a court. It has previously been recognised by the legislature that GMSLAs should be given special treatment on the commencement of insolvency or business rescue proceedings in respect of a party to such agreements, in order to allow for the orderly termination and set-off of obligations between the parties. In fact, the proposed amendment to section 136 of the New Act does provide for such protection from suspension of obligations by a business rescue practitioner. SASLA respectfully submits that the inadvertent omission be corrected, together with a small grammatical point described below, as set out in the *Proposal* annexure to this letter.

directors,
executives
&
consultants

law | tax | forensics | IP | africa

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* not attorney/not director, † executive consultant, ‡ consultant

level 3 BBBEE: AA rating

Introduction to SASLA and securities lending

3. SASLA is an industry forum established in 1989 to represent the common interests of the participants in the South African securities lending industry. Members of SASLA include all of South Africa's major banks and a number of overseas banks, as well as insurance companies, pension funds, asset managers, service providers and Strate. SASLA assists in the orderly, efficient and competitive operation and advancement of the South African securities lending industry. In this regard, SASLA works closely with regulators and is represented on the Strate Advisory Committee, JSE T+3 Committee and the JSE Corporate Actions Committee. SASLA has contributed to a number of major industry initiatives, including the development of the SA Stock Borrowing and Lending Code of Guidance and the GMSLA, which is the world-wide industry standard lending agreement published by the International Securities Lenders Association ("ISLA"). In addition, SASLA recently published standard securities lending documentation to be used in conjunction with the GMSLA, by participants in the South African securities lending market.
4. Securities lending provides lenders (most commonly pension funds¹) with low-risk yield enhancement to their portfolios, by enabling them to earn fees on loans and by providing effective hedging techniques. On the other hand, securities lending enables borrowers to cover failed or short sale trades, hedge risks and/or arbitrage in the market. Additionally, securities lending is crucial to the optimal functioning of the South African derivatives market, facilitates effective and efficient settlement of equities and bonds through Strate, and increases liquidity in tightly held equities and bonds, reducing the costs of adjusting portfolio holdings. Finally, securities lending constitutes a critical element of the arbitrage that ensures that futures and cash prices on the JSE are in tandem.
5. In addition to benefitting pension funds as lenders, securities lending supports hedge funds' trading activities and strategies. As mentioned above, securities lending is important in facilitating short sales of securities. During the recent financial crisis, some financial regulators² curbed short-selling in an attempt to stem the crisis. Academic research has shown, however, that facilitating short selling, and therefore securities lending: allows market prices to adjust more quickly to new information about fundamentals, decreases the likelihood of price bubbles, leaves unchanged or even reduces the probability of price crashes and leads to lower trading costs, higher turnover and improved market liquidity.

¹ An estimated 70% of all South African pension funds with net assets over ZAR 10 billion (excluding the Government Employees Pension Fund) participate in some form of securities lending program.

² Importantly, no such restrictions were introduced in the South African financial markets.

6. Securities loans are generally concluded and documented under a GMSLA. The GMSLA follows a master agreement format, allowing the parties to conclude an unlimited number of securities lending transactions, with both parties acting as either lender or borrower, under a single agreement. One of the most important concepts provided for in the GMSLA is the ability of the parties, on termination of the GMSLA for any reason, to net their obligations under all transactions and determine a single amount payable between them. Participants' confidence in this netting is vital to the securities lending industry.
7. At present, netting under GMSLAs and certain other agreements³ is accepted as fully enforceable under South African law. This is in part because the importance of netting was recognised as a key legislative policy consideration, as evidenced by the addition of sections 35A and 35B of the Insolvency Act, No. 24 of 1936 (the "Insolvency Act").⁴ Evidence of this policy consideration was also seen in the related carve-out in section 136(2) of the New Act, which recognised that a safe haven should be created in circumstances of financial distress for GMSLAs.
8. SASLA's main concern with item 83(b) of the Amendment Bill is that corresponding protection of from a court's cancellation power (provided in what would be section 136(2A)(b) of the Amended Act) appears to have been inadvertently omitted, even though such protection from a practitioner's suspension power is included in what would be section 136(2A)(a)(ii) of the Amended Act.

Background to set-off and netting

9. Set-off is a principle of South African common law, whereby contractual debts may be extinguished. The doctrine of set-off operates where two parties are mutually indebted to each other and all debts to be set off are liquidated, due and payable, and of the same nature. Common law set-off is only valid and binding if all of the requirements for set-off exist before the commencement of insolvency proceedings in respect of one of the parties to an agreement. Furthermore, parties are generally free to provide for contractual set-off in their agreements. Set-off may not operate, however, under common law or by contract, following the commencement of insolvency proceedings in respect of one of the parties to an agreement.
10. Section 35B of the Insolvency Act ("Section 35B") provides an exception to the common law prohibition on the operation of set-off following the commencement of insolvency proceedings in respect of a party to certain agreements. Specifically, Section 35B provides for statutory set-off or netting of obligations arising under agreements published by, among others, ISLA.⁵ The GMSLA is

³ Certain other agreements are treated in a manner similar to GMSLAs and also provide for netting. For purposes of this representation, however, we do not address such agreements specifically.

⁴ The effect of section 35B of the Insolvency Act, and of set-off generally, is described in greater detail below. As section 35A of the Insolvency Act is not relevant for securities lending purposes, it is not discussed in the remainder of this representation.

⁵ Section 35B does not allow the parties to apply netting as provided for in the GMSLA, but rather mandates its own version of statutory netting.