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Honourable T Mufamadi, MP
Chairperson
Standing Committee on Finance
National Assembly

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Dear Sir

Comment on the Financial Markets Bill 2012

The Banking Association South Africa appreciates the opportunity to submit its comments on the Financial Markets Bill ("the Bill") to the Standing Committee on Finance, and requests an opportunity to present its views to the Committee during the public hearings on the Bill on 29 May 2012.

We would like to acknowledge the consultative and constructive approach taken by National Treasury ("NT") in the drafting of this important statute and we welcome the opportunity for further engagement during the Parliamentary process. The revisions made to the Bill since its initial publication in August 2011 address some of the sector's concerns and are acknowledged and appreciated.

This submission focuses on two policy matters that are of concern to the banking sector. These are:

(1) the regulatory approach to financial markets infrastructure, known as the Self-regulatory Organisation ("SRO") model; and

(2) the enabling framework for the regulation of derivatives.

In addition, a number of technical issues are highlighted in the **Appendix** to this submission, for the Committee's review.

1. An appropriate regulatory framework for South Africa

There are many elements of the Bill that are welcomed and supported; including the widening of the regulatory framework, and the enabling framework for the regulation of OTC derivatives. Nevertheless, all new legislation should be tested against general principles of effective regulation:

- Appropriate for South Africa;
- Balances predictability and certainty with the need for some flexibility;
- Coherent and "joined-up";

- Transparent and user-friendly,
- Informed by public participation;
- Targeted to the problems it seeks to remedy and proportionate to the costs, benefits, and risks involved; and
- Minimises unintended consequences.

There is a need for a holistic approach to regulation of the financial sector in South Africa. While the cost to society of a failure in financial systems is generally much higher than in other industries and the risk of destructive transmission is far greater with financial networks spanning many segments of the real economy, there is a need to guard against drawing the wrong conclusions about the causes of the global financial crisis. Expanded or amended regulation can of itself introduce new risks.

The local regulatory framework needs to be aligned with international standards; however, cognizance needs to be taken of the need to adapt international standards to local conditions. Due consideration of national priorities and differences should be taken into account to ensure that international standards are implemented within a robust framework, but with appropriate flexibility so as not to unfairly prejudice South Africa's well regulated banking system or stifles economic development.

The Bill seeks to modernise South Africa' securities regulatory framework and to bring it into line with international best practices as set out by the International Organisation of Securities Commissions (IOSCO); it also seeks to provide an enabling framework for regulations that will give effect to South Africa's G20 commitments on financial sector regulatory reform following the global financial crisis. These objectives are supported by the banking sector.

The financial sector reform programme underway in G20 countries has significant implications for the domestic banking sector and its role in facilitating and supporting economic development through lending, investment, and financial inclusion. Of particular importance is government's proposed move to the "Twin Peaks" model of financial regulation whereby prudential regulation is the responsibility of one regulator, and issues of consumer and investor protection are the responsibility of another separate market conduct regulator. The implementation of Twin Peaks has implications for the regulation of the financial markets and, arguably, the Bill does not sufficiently reflect these impending changes and will require subsequent amendments.

To better understand developments in financial markets regulation in other G20 countries, we commissioned Promontory (a well-respected international consulting firm) to conduct a benchmarking exercise of the Bill against securities regulation in other jurisdictions. The findings and recommendations of this exercise indicate that the Bill could be strengthened in several areas, particularly in respect of the SRO model and the regulation of derivatives. A copy of the Promontory paper titled "*An Independent White Paper on: South Africa's Financial Markets Bill*" is attached as an **Annexure** to this submission. The document has already been discussed with NT, the Financial Services Board ("FSB") and the South African Reserve Bank.

2. SRO Model

SROs are non-governmental organisations that have been given regulatory responsibilities and powers in relation to participants in financial markets such as banks and stock-brokers. These regulatory duties usually include rule making, supervision, and enforcement. In South Africa, both the Johannesburg Stock Exchange ("JSE") and Strate, a central securities depository ("CSD") for the electronic settlement of financial instruments are SRO's licenced by the Registrar of Securities Services at the FSB.

The SRO model is in place in many countries. However, South Africa currently has a particularly extreme form of the model in respect of the range of powers and responsibilities granted to SROs. The most common SRO model is a more limited exchange SRO model where the regulatory authority (such as the FSB) retains the majority of the regulatory functions. Many countries do not grant SRO status to CSD's such as STRATE, or to clearing houses.

It is understood that NT is undertaking a review of the SRO model which may in time result in legislative changes. Nevertheless, the role of SROs, such as the Johannesburg Stock Exchange, is so critical to the efficient functioning of local financial markets that we believe there is merit in the Portfolio Committee considering whether the provisions of the Bill are appropriate and adequate for South Africa.

The sector's concerns centre on the potential for conflicts of interest inherent in the SRO model. In essence, the SRO is both a player and the referee in the financial markets. There are numerous examples of where these conflicts of interest have emerged and without a robust mechanism for the management thereof, the efficient functioning of domestic financial markets infrastructure could be compromised. To address this concern, we believe that it is critical for the Bill to provide for strong regulatory oversight of the SROs; as well as formal remedial mechanisms to address concerns about conflicts of interests and to ensure that the SRO regulates in a fair and effective manner.

There are several provisions of the Bill in respect of the SRO model that are of concern to the banking sector. These relate to the following issues:

- the commercial activities of SROs;
- the management of SRO conflicts of interest; and
- SRO rule-making processes.

Each of these issues is addressed in turn below.

The Committee is also referred to pages 14 to 24 of the Promontory report which look at the powers and responsibilities of the regulator, in this case the Registrar at the FSB; as well as pages 25 to 37 of the report which examine the SRO model.

2.1 SRO's and commercial activity

In South Africa, SROs have been allowed to undertake commercial activities alongside their primary function of regulation. Although this is not in itself a concern, there is a need to address the systemic relevance of the commercial activity in the Bill.

We welcome the new provisions of Clause 62 relating to the carrying on of additional business by an SRO. The commercial operations of the SRO are however in this section, largely viewed by the registrar from the perspective of the impact on the SRO's ability to discharge their regulatory obligations or potential conflicts of interest. While the registrar must consider the likely impact of any additional business on the SRO's ability to perform its regulatory functions, the registrar's responsibility should extend to considering the impact of the proposed commercial activity on the efficient and effective functioning of the financial markets. The rationale for this is that in South Africa currently there is a single exchange (the JSE) and a single central securities depository (Strate).

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 Clause 2 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.

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. This proposed revision is set out in the **Appendix** to this submission (Item 4.2).

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. It is also proposed that Clause 62 (carrying on of additional business) is amended to require the registrar to have due regard to the impact of the proposed additional business by an SRO on systemic risk and the efficient functioning of the financial markets.

A related concern is the limitation of liability for SROs in Clause 73 of the Bill. The extent to which an SRO may be held liable is too limited given the blurring between its regulatory and commercial functions that occurs in practice. The Bill provides a fairly broad indemnity to SROs and to their employees, under which they are indemnified against liability for loss or damage sustained by any action or inaction on their part, except for instances of gross negligence. There have been instances, where the decisions taken by an SRO have resulted in significant losses to banks and for which there are limited remedies available. A stronger liability clause is regarded as being necessary to ensure that the regulatory framework for SROs is sufficiently robust and provides an adequate remedial mechanism. In terms of the limitation of liability clause, SROs and their employees are indemnified from the negligent performance of an obligation or function. This introduces an asymmetry in the standard of conduct expected of authorised users, participants and clearing members and the standard of conduct expected of a SRO. All regulated persons should be held to equivalent standards of behaviour.

Further to these issues, the following amendments are proposed:

2.1.1 *Clause 2-Objects of the Act*

Insert new sub-clause 2(d):

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

2.1.2 Clause 62-Carrying on of additional business

Insert new sub-clause 62(1)(iii):

"(iii) introduce systemic risk."

Insert new sub-clause 62(2)(iii):

"(iii) be systemically relevant"

2.1.3 *Clause 73-Limitation of liability*

73(1) No self-regulatory organisation, trade repository, chief executive officer, other officer, employee or representative of a self-regulatory organisation or trade repository, or any member of a controlling body or committee of a controlling body of a self-regulatory organisation or director or official of a trade repository, is liable for any loss sustained by or damage caused to any person as result of anything done or omitted in the performance of its regulatory or commercial functions by –

(a) the self-regulatory organisation, trade repository, chief executive officer, other officer, employee, representative or member in the bona fide **[or negligent (excluding grossly negligent)]** performance of an obligation or function under or in terms of this Act, the listing requirements of an exchange or the rules or exchange, depository or clearing house directives; or

(b) a clearing member, an authorised user or participant.

(2) …

2.2 SRO's and Conflicts of Interest

The "strong" SRO model currently in place in South Africa suffers from inherent conflicts of interest. These conflicts can arise between an SRO's commercial and regulatory functions; as well as between an SRO's activities and the activities of the market participants regulated by that SRO. It is for this reason that other countries, such as Australia, have recently moved away from the "strong" SRO model.

The failure to adequately manage these conflicts can result in inefficient and uncompetitive financial markets, undermining South Africa's economic development. Given the monopoly power of SROs in South Africa, we believe that the Bill needs to be strengthened to address this serious matter through:

- Requiring the Registrar to oversee the management of conflicts of interest by an SRO;
- Providing a formal mechanism for market participants to lodge complaints about conflicts of interest with the Registrar;
- Requiring an SRO to subject its management of conflicts of interest to external review on an annual basis; and
- Requiring, as part of the licensing conditions of an SRO, a governance framework that clearly separates oversight of commercial and regulatory activities.

Strengthening the Bill in this manner would also be consistent with IOSCO principles for securities regulation which state that "*The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed*."

The following amendments are proposed:

2.2.1 *Clause 5-Minister, Registrar and Deputy Registrar of Securities Services*

New sub-clause 5(3)(o)-

"In performing those functions the registrar-

Must take steps to ensure that an SRO ensures that conflicts of interest are avoided, eliminated, disclosed or otherwise managed."

2.2.2 *Clause 96-General powers of registrar*

New sub-clause 96(2)-

"If the registrar receives a complaint from a regulated person in relation to the management of conflicts of interest by an SRO, the registrar will investigate the matter provided that:

(i) such regulated person can provide proof that the matter has been brought to the attention of the SRO, and either

(a) the SRO has refused to address the complaint, or

(b) a reasonable period of time has elapsed for the SRO to respond given the nature and urgency of the complaint, or

(c) the SRO has not addressed the matter completely, and

(ii) the conflict persists."

2.2.3 *Clause 63-Conflicts of interest*

New Clause 63 to replace the current clause-

"(1) A self-regulatory organisation must take necessary steps to avoid, eliminate and manage possible and actual conflicts of interest.

(2) A self-regulatory organisation must disclose to the Registrar any direct or indirect conflicts of interest between its regulatory functions and commercial functions immediately upon become aware of such actual or potential conflicts, and must take such steps to manage any direct or indirect conflicts of interest which steps shall include, without limitation, –

(a) an annual independent external audit of the self-regulatory organisation which reviews the manner in which conflicts of interests are managed, lists the conflicts experienced in the year of audit and details any conflicts that have been identified but not managed in accordance with the code of conduct prescribed by the Registrar in sub-section (3)(a); and

(b) the provision of the results of the audit referred to in subparagraph(a) to the Registrar by the self-regulatory organisation immediately upon its completion.

(3) The Registrar in reviewing and monitoring the conflicts of interest of self-regulatory organisations must –

(a) prescribe a code of conduct for the managing of conflicts of interest by self-regulatory organisations, which will include

provisions in respect of the scope and manner in which the annual audit referred to in sub-section (2)(a) is to be conducted; and

(b) conduct an annual review of a self-regulatory organisation's conflicts of interest mechanisms and compliance with the code of conduct referred to in subparagraph (a); and

(c) conduct an annual review of a self-regulatory organisation's pricing, pricing policies and market conduct in respect of its commercial and regulatory functions.

(4) The Registrar shall prescribe the manner in which participants, authorised users, clearing members and nominees may lodge complaints with the Registrar of conflicts of interest of the self-regulatory organisations and the procedures for the adjudication and resolution of the complaint.

2.2.4 *Chapter VII-General provisions applicable to self-regulatory organisations*

Insertion of new clause – Governance of SROs

A self-regulatory organisation must appoint a Board committee separate from the Board to oversee the regulatory functions of the self-regulatory organisation

The Board committee should have a minimum number of independent directors as prescribed in regulations

2.3 SRO Rule-making

The conflicts of interest problem often manifests in the rules set and directives issued by an SRO in relation to authorised users and market participants. These rules and directives often have significant implications for authorised users and as such it is imperative that SROs are obliged to consult with affected parties.

Sub-clause 72(2)(a) of the Bill provides the SRO with specific powers and obligations pertaining to these rules. We welcome the introduction of the obligation on the SRO to consult on amendments to the rules. However, the SRO in the application of the rules can also issue directives and enter into contracts with the market without any obligation to consult. It would therefore be appropriate to extend the required consultation with regulated persons to directives and to contractual arrangements. The specific details of the consultation, including the persons to be consulted, the time period for consultation, and any specific directives that should be exempted from this requirement (such as those that prohibit specific behaviour) should be outlined in the rules of the SRO.

The following amendment to Clause 72 of the Bill is proposed:

2.3.1 *Clause 72-Manner in which rules of self-regulatory organisation may be made, amended or suspended and penalties for contraventions of such rules*

Insert into sub-clause 72(2)(a) new sub-clause (iii):

(iii) consultation on new directives and contractual arrangements, as well as changes to existing directives and contractual arrangements.

3. OTC derivatives and cross-border jurisdictional issues

Given the global nature of financial markets, it is imperative that the Bill strikes the appropriate balance between facilitating efficient cross-border financial transactions while allowing domestic regulators sufficient powers of oversight and supervision to manage risks within the domestic market. In finding this balance, it is important to recognise the relative size of the South African financial markets in comparison with other markets, as well as the need for global harmonisation of regulation in line with the commitments made by the G20. The regulation of derivatives is complex and many countries are currently debating an appropriate regulatory framework. We support the approach adopted by NT to develop a detailed regulatory framework for derivatives in South Africa in a consultative and gradual manner. Given the size of the South African derivatives market, there is little to be gained from being a first-mover in this regard. We also welcome the role given to the Minister of Finance and the Governor of the Reserve Bank in respect to regulating in this area, as well as the commitment to subject proposed regulations to an economic impact assessment before finalisation. This is an important mechanism to minimise unintended negative consequences for the South African economy.

3.1 Reporting

The G20 commitments require South Africa to put in place an enabling framework for the reporting of derivatives trades to a Trade Repository ("TR"); clearing standardised derivatives trades through a central clearing house; and trading derivatives on an electronic execution venue. The Bill provides this enabling framework and it is understood that the details thereof will be dealt with in regulations. It is therefore imperative that the enabling framework in the Bill does not inadvertently preclude any particular option for regulating derivatives that are still to be developed, debated and assessed.

One of the issues being considered in this process is the use of external financial market infrastructure, such as a TR located in another country, by South African banks and other market participants. For example, in respect of the mandatory reporting of OTC derivatives to a TR, the need for South African regulators to monitor the build-up of systemic risk in the financial system as part of their macro-prudential supervision is supported. A well-designed TR is able to play an important role in this regard. However, in considering the need for a local TR, it is suggested that consideration is given to the existence of well-established TRs in other countries. These TRs allow access to their databases by many regulatory authorities from different countries. Several G20 countries, including Australia and Canada, as well as the European Commission, are considering the merits of recognizing external TRs for the purposes of mandatory reporting provided such TRs are subject to equivalent supervisory standards and are accessible to the home regulators. This

approach also facilitates a harmonization of reporting standards across jurisdictions to facilitate aggregation of information and to minimize opportunities for regulatory arbitrage.

In this regard, we propose an amendment to Clause 54 of the Bill which deals with applications for a TR licence. The current wording of sub-clause 54(2) limits the parties who may apply for a TR licence to companies registered in terms of the Companies Act. This automatically excludes TRs that have their headquarters in another country from qualifying as a licensed TR in South Africa, providing services to the local market. In keeping with the general principle-based and enabling nature of the Bill, the specific and detailed licence conditions of TRs should be left to the regulations.

It is therefore proposed that sub-clause 54(2) is amended to replace the current wording with the following:

"A juristic person (company incorporated in terms of the Companies Act) may apply to the registrar for a trade repository licence ...".

This amendment is consistent with sub-clause 46(2) of the Bill, which deals with applications for clearing house licenses, and which provides that a juristic person may apply for such a licence. The proposed revision to sub-clause 54(2) will have the effect of not preventing a TR that is registered (and regulated) in another jurisdiction from applying for a licence to operate in South Africa.

3.2 Clearing

It is worth noting that while South Africa, together with most G20 countries, is still developing the detailed regulatory framework for OTC derivatives, from January 2013 new rules related to how OTC derivatives are to be treated in terms of prudential regulations pursuant to the Banks Act come into force. These new rules, which are part of the Basel III banking reforms, require banks to hold more capital against OTC derivatives which are not cleared through a central clearing house. Furthermore, new regulatory requirements in respect of using a central clearing house may come into effect in other countries with which South Africa trades. The implications of these developments is that South African banks may be compelled in terms of the regulatory requirements of other jurisdictions to use external clearing houses before the South African regulatory regime has been finalised. This is not a problem in itself as long as the Bill does not prevent the use of the services of a foreign clearing house that is not designated as an external clearing house(i.e. not licensed as a clearing house in terms of the Act) in the Regulations. Currently, the Bill is appropriately silent on this matter in accordance with NT's gradual approach to OTC derivative regulation in South Africa. However, there is a need to review the definition of "clearing member" in the Bill to ascertain whether or not the definition introduces an inadvertent obstacle to a South African bank becoming a clearing member of a foreign clearing house that is not designated as an external clearing house in the Regulations.

4. Appendix

4.1 Clause 1 – Definitions and interpretation

In order to be consistent with the definitions in Financial Services Board Act 97 of 1990 we propose the following amendment to the definitions.

4.1.1 *Bank*

"bank" means a bank as defined in the Banks Act, 1990 (Act No. 94 of 1990), and a mutual bank as defined in the Mutual Banks Act, 1993 (Act No. 124 of 1993)**[;]** or a co-operative bank as defined in the Co-operative Banks Act, 2007 (Act No. 40 of 2007);

4.1.2 *Derivative instrument*

We acknowledge that the definition of *"derivative instrument"* has been retained from the Securities Services Act ("SSA"); however we submit that this definition is too broad and may result in unintended consequences if it strictly applied. For example, all contracts that sets out the terms for the provision of credit for the purchase of an asset are caught in this definition as it provides for *"…any … contract that creates rights and obligations and that derives its value from the price or value…of some other particular product or thing*".

We believe that careful consideration needs to be given to the definition of a derivative instrument and we propose the definition in the Bill is replaced with the definition used in the joint publication of the Bank for International Settlements Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions ("IOSCO") publication *"Principles for financial market infrastructures"* published in April 2012:

"derivative instrument" means a financial contract whose value depends on the value of one or more underlying reference assets, rates or indices, on a measure of economic value or on factual events;

In addition, we note that the term 'derivative instrument' is the only security, in the list of securities included in the definition of *"securities"*, in the Bill that has been separately defined and that a specific derivative instrument, *"instruments based on an index"* is separately listed in the definition of securities (sub-clause (a)(vi)).

4.1.3 *Juristic person*

The term *"juristic person"* is not defined in the Bill. If it was intended that the meaning in the Bill aligns with the meaning contemplated in the Companies Act, then it is not clear whether the meaning includes an 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.

We submit, for the sake of clarity, that the term *"juristic person"* should be defined in the Bill. We further note that if the intention

was to exclude associations then clauses 15, 51 and 64 may be redundant and if the intention was to include associations and partnerships, the provisions of clauses 66 and 68 should be expanded to contemplate associations and partnerships.

4.2 Clause 5 – Minister, Registrar and Deputy Registrar of Securities Services

The full term of the definition for "Governor" is used in sub-clause 5(3)(n). We propose that this sub-clause be 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.

Clause 5(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 G20 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-clause 5(6) is amended and the introduction of a definition as set out below:

''execution venue'' means a person authorised by this Act to operate any electronic system or facility, which is not an exchange, and in which professional market users buying and selling securities are able to interact in the system in a way that results in a transaction;

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

4.3 Clause 10 – Listing of securities

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

(3) If a person fails to pay a fine or **[compensation]** penalty 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]** penalty payable, and

such statement thereupon has all the effects of a civil judgment lawfully given in that court against that person in favour of the exchange for a liquid debt in the amount specified in the statement.

4.4 Clauses 59, 60 and 61 –renewal, cancelation suspension a of a licence of a self-regulatory organisation

Clause 59 requires a SRO to renew its license in advance of the automatic expiry of the license on 31 December each year and Clause 60 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 license was not renewed, other than suspension pending possible cancellation or outright cancelation, as envisaged in Clause 61.

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 issue is dealt with in paragraph 2.1 of our submission.

This leaves the registrar with one alternative in terms of Clause 61 – *"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 license 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 Clause 59 be amended to reduce the obligation of the registrar to act at the renewal of the license and propose the following insertion:

(3) A renewal of the license by the registrar does not detract from any actions taken, or yet to be taken by the registrar under Clause 61.

This wording or similar wording should enable the registrar to reissue the license 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 Clause 60 does not provide an additional benefit to the registrar as each of the rights conferred under Clause 60 are already available under Clause 61 and we note that Clause 61 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 Clause 60 be deleted in its entirety and Clause 61 is amended as follows:

Cancellation, [or] suspension or refusal of renewal 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 or refusing to renew a licence—

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

(b) give the self-regulatory organisation the reasons for the intended cancellation, **[or]** suspension or refusal to renew; 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.

4.5 Clause 72 – Penalties imposed by a self-regulatory organisation

Clause 72(6)(a) lists a number of penalties, including in sub-clause (iii) a fine not exceeding R 5 million, for any contravention or failure to comply with the rules.

The use of the words "…for any contravention…or failure to comply…" need to be tempered for the severity of the offence and we propose the following amendment:

"(6) (a) The rules may prescribe that a self-regulatory organisation, or a person to whom the self-regulatory organisation has delegated its disciplinary functions, may where appropriate, impose any one or more of the following penalties for contravention thereof or failure to comply therewith:"

The qualification will provide a reasonability test when challenging the severity of the fine in terms of Clause 107(1)(i) to the appeal board in the Financial Services Board Act.

4.6 Sub-Clause 74(1) – Disclosure of information by self-regulatory organisation

This sub-clause prohibits a self-regulatory organisation, it's officers, employees, representatives and members from *"disclosing confidential information obtained in the performance of functions under this Act…"*, subject to certain circumstances. We note that the Bill does not provide for an offence or penalty in the event of a breach of this provision

This is indicative of the asymmetry in the standards of conduct referred to in paragraph 2.1.3 of our submission, as a SRO is not held to the same standard of conduct to which authorised users, participants and clearing members are held.

In light of the impact of failure to comply with this provision, we recommend that a provision for an offence and a severe penalty be made in Clause 111 of the Bill and we suggest the following amendment:

Offences and penalties

111. A person who—

(a) …

(d) contravenes or fails to comply with the provisions of section 74(1) commits an offence and is liable on conviction to a fine not exceeding R50 million or to imprisonment for a period not exceeding 10 years, or to both such fine and such imprisonment.

4.7 Clause 80 – Insider Trading

Clause 80 of the Bill creates an offence of insider trading. Listed Companies (issuers) will however always have inside information but may want to trade in their own listed securities. In addition they may appoint agents, typically corporate finance advisors, sponsors as well as brokers. In the course of acting for issuers, these service providers have inside information. The issuers and their service providers need to be excluded from the ambit of Section 80 in order to facilitate corporate actions.

The current wording of Section 80 does not provide these parties any safe harbour.

4.8 Clause 82 - Prohibited trading practices

We acknowledge that sub-clause 82(1)(a) provides a general provision which qualifies a "manipulative, false or deceptive practice of trading" with intent:

> "…which practice may, if executed, create -
>
> (i) a false or deceptive appearance of the trading activity in connection with; or
>
> (ii) an artificial price for,
>
> that security;"

However, sub-clause 82(3)(a), which deems that "…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" is a "manipulative, false or deceptive trading practice", does not provide for the qualification of intent. Consequently, this activity appears to be a presumptive offence as it is the only activity set out in sub-clause 82(3) (a) to (e) without the provision for the qualification of intent.

This absence of qualification of intent is problematic for banks who act as market-makers in listed derivative instruments. A market-maker may be required to correct or set a reference or ruling price on an illiquid derivative and the market-maker achieves this by entering a buy and sell order for that derivative at a fair market price. The intention of the market-maker is to correct the price with no intention to manipulate the price or create a false or deceptive appearance of trading activity.

The term "connected party" used in sub-clause 82(3)(a) is not defined in the Bill. In any event, we believe that the reference to a connected party does not enhance the substance the sub-clause, as it is covered by the term "indirect". (i.e. a person with an indirect beneficial interest is a connected party).

Therefore, we propose that sub-clause 82(3)(a) is amended as follows:

> (3) Without limiting the generality of subsection (1), the following are deemed to be manipulative, false or deceptive trading practices:
>
> (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, including where a person [or a connected party] had a direct or indirect beneficial interest in the securities and continues to have such an interest in the securities after the transaction, <u>with the intention of creating –</u>
>
> <u>(i) a false or deceptive appearance of the trading activity in connection with; or</u>
>
> <u>(ii) an artificial price for,</u>
>
> <u>that security;</u>

(b) …

4.9 Clause 97: Powers of registrar to conduct on-site visits or inspections

This Clause co-joins two very different actions. The first being an on-site visit which is a more cordial engagement with an inspection being viewed as a more adversarial visit. Although both functions are necessary, there needs to be a clear separation of the powers allocated to these two different functions to avoid confusion on the part of the regulated entity.

We propose that in Clause 97, the two functions are separated and the respective powers allocated accordingly. The majority of Clause 97 is devoted to the inspection function. We would therefore expect that an on-site visit would be arranged in advance of the meeting, with the scope and purpose clearly defined to provide for meaningful engagement. On-site visits would afford the regulated entity the opportunity of raising its own matters for discussion.

If this Clause is not intended for on-site visits then the title should be changed to reflect the more appropriate search and seizure provisions contained therein.

We would propose the following wording, 'powers of the registrar to conduct on-site inspections'. This would leave no doubt that the approach is not a visit and would make Clause 98 more appropriate.

The terminology used in Clause 97(1)(a) does raise some concerns in any event.

> 97. (1) The registrar may—
>
> > (a) authorise any suitable person to conduct an on-site visit of the business and affairs of a regulated person to determine compliance with this Act; or
> >
> > (b) …

We believe that the registrar should appoint a suitably trained person from within the FSB to conduct an investigation and in the event that the FSB is unable to present such a person for the purpose envisaged, then they may appoint an inspector as provided for in Clause 97(1)(b) of the Bill.

> (b) instruct an inspector under section 3 of the Inspection of Financial Institutions Act, 1998 (Act No. 80 of 1998).

The Inspection of Financial Institutions Act provides for specific confidentiality provisions for inspectors under paragraph 8, Observance of secrecy, as well as in the Financial Services Board Act under Section 22, Preservation of secrecy for the staff of the FSB. Both these sections in their respective pieces of legislation require high standards of confidentiality.

4.10 Clause 101 - Referral to enforcement committee

As the directives issued by an exchange, depository or clearing house are usually operational requirements binding on authorised users,

participants and clearing members respectively, 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 clause should be amended as follows:

> 101. 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.

4.11 Clause 109 - Regulations

This Clause is silent on how regulation prescribed by the Minister is to be communicated. None of the references in the Bill that require the Minister to make regulation are of a systemic nature that would not be suitable for the publication in the Gazette. In addition, both the Companies Act and the Consumer Protection Act require that regulations are published for public comment for a period of not less than 30 days.

We are mindful that both the Minister and the Governor must have greater powers to manage systemic risk in line with their mandate and such, a provision of a mandatory 30 days would be inappropriate. We do however expect that the systemic risk management powers will be contained in a separate, as yet to be announced, piece of legislation that will give evidence to the Twin Peaks policy. Consequently, we propose an amendment to the definition of 'prescribed by the Minister' as provided in Clause 1 and amendments to Clause 109 follows:

"prescribed by the Minister" means prescribed by the Minister by regulation, in terms of section 109;

109. (1) The Minister may make regulations not inconsistent with this Act with regard to—

(a) any matter that is required or permitted to be prescribed in terms of this Act; and

(b) any other matter necessary for the better implementation and administration of the Act or a function or power provided for in this Act:

Provided that in making regulations the Minister must maintain the operational independence of the registrar.

(2) The Minister must cause the publication in the Gazette of a notice of any proposed regulations, calling upon all interested persons who have any objections to the proposed regulations, to lodge their objections with the Minister within 30 days of the publication of the notice.

4.12 Schedule – Laws Repealed or Amended

The Bill provides for the consequential amendment to section 45(1)(a)(i) of the Financial Advisory and Intermediary Services Act ("FAIS") which effectively exempts persons licensed or regulated under the governing securities legislation from the provisions of FAIS. We acknowledge National Treasury's observation that a corresponding

provision in the Bill that exempts persons from FAIS would be duplication and is not necessary.

We are concerned that the amendment to FAIS, as provided in the Bill, introduces uncertainty in respect of the application of the exemption. We have set out, below, the effect of the amendment to FAIS and particular definitions to illustrate our contention. To appreciate the extent of the meaning of *"financial services"* contemplated in FAIS, it is necessary to examine the definitions of *"financial services provider"* and *"intermediary services".*

Amended Section 45 of FAIS

"(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", "licensed exchange", or "participant" as defined in section 1 of the Financial Markets Act, 2012, to the extent that the rendering of those services are specifically supervised under that Act;

(ii) …"

"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;

"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;

The uncertainty with respect to the exemption is created in two ways. Firstly, the Bill does not define "financial services", rather the Bill defines "securities services", which services do not directly correlate with the services under the definition of "financial services", other than advisory services, provided for in FAIS. Secondly, the definition of "intermediary services", as provided for in FAIS is so broad that it includes "any act other than the furnishing of advice".

Consequently it is not clear which "financial services" contemplated in FAIS "will be "specifically supervised" under the Financial Markets Act. In an attempt to alleviate this uncertainty, we suggest that the amendment to FAIS, as provided for in the Bill, is amended as set out below:

Schedule

LAWS REPEALED or AMENDED

No. and year of Act	**Short title**	**Extent of repeal or amendment**
Act No. 36 of 2004	Securities Services Act	The whole.
Act No. 37 of 2002	Financial Advisory and Intermediary Services Act, 2002	**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'', ''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, to the extent that the rendering of **[those]** financial services are **[specifically supervised]** licensed or authorised as securities services by or under that Act;"[#]

[#]**Proposed amendments marked-up in red font.**

We trust that you will review the suggestions in a favourable light and should you wish to discuss any aspect of our submission in more detail, we would welcome the opportunity to engage with you.

Assuring you of our best attention at all times.

Yours faithfully

Mark Brits

General Manager Banking and Financial Services