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25 May 2012

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Dear Sir

Comments on the Financial Markets Bill [B12-2012]

Please find our comments on various aspects of the Financial Markets Bill [B12-2012] (**FMB**) below.

1 **Definition of nominee**

1.1 The definition of "nominee" under the *Securities Services Act, 2004* (**SSA**) is a person that acts as a registered holder of securities or an interest in securities on behalf of other persons.

1.2 However, a nominee under the FMB is a person approved under section 78 of the FMB to act as the holder (not the registered holder) of securities or of an interest in securities on behalf of other persons.

1.3 Section 78 essentially creates three types of persons who can be a nominee:

(1) in the case of the nominee of an authorised user, a person approved by the exchange in terms of the exchange rules;

(2) in the case of a nominee of a participant, a person approved by a central securities depository in terms of the depository rules; and

(3) a person who complies with the requirements prescribed by the registrar and is consequently approved by the registrar.

1.4 The amendment of the definition of "nominee" causes a shift from including both regulated and unregulated nominees, to include only regulated nominees. This will mean that informal arrangements will no longer be allowed, unless such person is approved in terms of section 78.

1.5 Further, the FMB suggests an amendment to the *Companies Act, 2008* (**Companies Act**) in order to, amongst others, incorporate this definition into the Companies Act. The term "nominee" is used in three sections of the Companies Act, other than the definitions, namely sections 3 (Subsidiary relationships), 41 (Shareholder approval for issuing of shares in certain cases) and 124 (Compulsory acquisitions and squeeze-outs).

1.6 In our view, the use of the term in the Companies Act does not envisage the concept of an approved nominee only, for example the issuing of shares under section 41, especially in the instance of small unlisted companies.

2 Definition of nominal value

2.1 A definition of "nominal value" has been inserted into the FMB. This definition distinguishes between securities other than shares in a public company and shares in a public company.

2.2 The Explanatory Memorandum on the Financial Markets Bill (**Explanatory Memorandum**) states that the purpose of this definition is to align the FMB with the Companies Act which has done away with the requirement for shares to have a nominal value.

2.3 The nominal value in respect of shares in a public company has been replaced by a fixed value assigned to a share on first issue and used to assess dividend, capital ownership or interest on the value of the shares calculated or determined in accordance with the Companies Act, depending on whether the shares have been issued prior to or after the conversion provided for under the Companies Act. For all other securities, the nominal value is a fixed value assigned to that security on first issue and used to assess dividends, capital ownership or interest.

2.4 It is not clear, even from the Explanatory Memorandum, why shares in public companies have been distinguished from all other securities.

3 Definition of insolvency proceeding

3.1 The FMB proposes the definition of "insolvency proceeding". "Insolvency proceeding" is defined to mean "a judicial or administrative proceeding, or both, authorised in or by national legislation or the laws of a country other than the Republic, including an interim proceeding, in which the assets and affairs of a person are subject to the control or supervision by a court of an insolvency administrator for the purpose of re-organisation, business rescue, curatorship or liquidation, and includes, but is not limited to, any such proceeding under:

(1) the Companies Act;

(2) the Insolvency Act;

(3) the Banks Act;

(4) the Financial Institutions (Protection of Funds) Act; and

(5) the National Payments System Act."

3.2 This definition is identical to the definition in the Rules of Strate Limited (as updated in Government Gazette no. 34811 dated 9 December 2011).

3.3 According to the Explanatory Memorandum, the purpose of the insertion is to provide for a legal process guaranteeing account holders protection during insolvency or failure of a participant, authorised user, clearing member or client. Furthermore, on the insolvency of a central securities depository (**CSD**), CSD participant, authorised user, clearing member or client, it is necessary that legal clarity exists on the protection measures in the interest of financial stability, protection of role players and consumers and the reduction of systemic risk.

3.4 According to section 1(2) of the FMB:

(a) a business rescue proceeding commences for purposes of the FMB in terms of section 132(1) of the Companies Act[1];

(b) **a judicial proceeding commences on the written notification to the registrar or a regulated person of either an application or granting of an interim order, whichever comes first;** and

(c) in relation to an administrative proceeding, on the filing of a resolution by a company or the appointment of an insolvency administrator, as the case may be, in accordance with national legislation or the laws of a country other than the Republic.

3.5 The main issue with this definition arises from section 1(2)(b) which conflicts with the common law. In terms of our common law, insolvency proceedings are deemed to have commenced on the filing at court of an application for insolvency proceedings. It is conceivable that a time delay could exist between the date of filing and the date on which the Registrar is notified and this may result in uncertainty.

4 Definition of securities

4.1 In terms of section 1 of the FMB, the definition of "securities" in the SSA will be amended to:

(1) include both listed and unlisted instruments; and

(2) restrict bonds to those issued by public companies, public state-owned enterprises and the Government of the Republic of South Africa.

4.2 According to the Explanatory Memorandum, the purpose of the amendment is to clarify that the reference to securities in the FMB includes both listed and unlisted securities. The amendment further seeks to correct the reference to money market instruments, to refer instead to money market securities, a term which has been defined. This reaffirms the Registrar's proposed ability to regulate unlisted securities in line with IOSCO and G20 recommendations.

4.3 A problem arises in the amendment sought by the FMB to the Companies Act. The FMB seeks to incorporate the definition of securities into the Companies Act, adding that in the context of the Companies Act, it includes shares in a private company. This may pose a number of problems if one considers that the definition in the first draft of the Companies Act incorporated the definition in the SSA. This was, however, rejected and the definition in the enacted version of the Companies Act reads "any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company".

4.4 If this proposed amendment to the Companies Act is implemented it means that the offering of participatory interests in a collective investment scheme, which is dealt with in terms of the *Collective Investment Schemes Control Act, 2002,* will then be regulated under the Companies Act, and this is incorrect. Similarly it is inappropriate in the Companies Act to deal with bonds or debentures which are not convertible into equity in the same manner as other types of securities.

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[1] Section 132(1) of the Companies Act provides that business rescue proceedings begin when:
(a) the company files a resolution to place itself under supervision in terms of section 129(3) or applies to the court for consent to file a resolution in terms of section 129(5)(b); or
(b) an affected person applies to the court for an order placing the company under supervision in terms of section 131(1); or
(c) a court makes an order placing a company under supervision during the course of liquidation proceedings, or proceedings to enforce a security interest, as contemplated in section 131(7).

5 Pledge or cession to secure a debt

5.1 Section 38 of the FMB deals with a pledge or cession to secure a debt. In doing so, pledge and cession are being treated interchangeably when, in fact, they are distinctly different.

5.2 According to Law of South Africa, a pledge is a limited real right of security in a movable asset, created by delivery of the asset to the pledgee pursuant to an agreement between himself and the owner of the asset, by which it is sought to secure the fulfilment of an obligation due to the pledgee by the pledgor, or some third person.

5.3 The Law of South Africa further states that because the rights embodied in negotiable instruments are closely identified with the paper, the pledging of such documents results in these rights forming part of the pledgee's security. There has been a view expressed that transactions of this kind are of a composite nature, consisting of a pledge of the paper and a cession *in securitatem debiti* of the rights against the debtor embodied in them.

5.4 In *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) the court discussed the two "theories" with regard to cession *in securitatem debiti* in detail, the main points of which are summarised below:

(1) according to "the pledge theory", the effect of the cession *in securitatem debiti* is that the principal debt is "pledged" to the cessionary while the cedent retains what has been described as the "bare dominium" or a "reversionary interest" in the claim against the principal debtor; and

(2) according to the second theory, a cession *in securitatem debiti* is in effect an outright or out-and-out cession on which an undertaking or *pactum fiduciae* is superimposed that the cessionary will re-cede the principal debt to the cedent on satisfaction of the secured debt. In consequence, the ceded right in all its aspects is vested in the cessionary. After the cession *in securitatem debiti* the cedent has no direct interest in the principal debt and is left only with a personal right against the cessionary, by virtue of the *pactum fiduciae*, to claim re-cession after the secured debt has been discharged.

5.5 The court held that despite the doctrinal difficulties arising from the pledge theory, the Supreme Court of Appeal had in a series of decisions leading up to this case, primarily for pragmatic reasons, accepted the pledge theory in preference to the outright cession/*pactum fiduciae* construction and consequently the doctrinal debate must be settled in favour of the pledge theory.

5.6 In annexure A to the Explanatory Memorandum, the issue of cession and pledge is discussed. One commentator suggested the words "pledge and cession" be replaced with "cession *in securitatem debiti*" in order to make it clear that this section deals with a pledge and not an out-and-out cession.

5.7 According to Treasury's view, it was decided to retain the phrase "cession to secure a debt" as the correct legal term used for "incorporeals" (such as securities) and also plain English for "cession *in securitatem debiti*". The FMB, according to Treasury, clearly distinguishes between "pledge or cession to secure a debt" in terms of clause 38(1) and "out-and-out cession" as set out in clause 38(2). The intention is to provide for pledges as well as for out-and-out cessions.

5.8 The issue with Treasury's view is that it is suggesting that pledge and cession *in securitatem debiti* are two different concepts, when in fact they are not. Presumably what is meant by "the intention is to provide for pledges as well as for out-and-out cessions" is that the intention is to provide for cessions *in securitatem debiti* (which means that the pledge theory applies, per *Grobler v Oosthuizen*) and out-and-out cession. This means that there is no need to refer to both pledge and cessions *in securitatem debiti* and we therefore recommend that references to pledge are deleted.

6 **Regulations**

In terms of section 77 of the FMB, certain aspects of the regulation of unlisted securities (ie the requirements for the authorisation of persons providing securities services in respect of unlisted securities) will be dealt with in the regulations. This will be problematic if these are not put through a consultation process. In our view it is imperative to have a financial market that is fair and transparent.

7 **Market abuse**

7.1 For ease of reference, a comparative analysis of the provisions in the SSA and FMB has been prepared and is attached to this submission as Annexure "A".

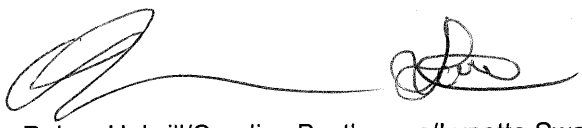
7.2 A new defence (section 80(1)(b)(ii) and 80(2)(b)(iii)) has been included for transactions amongst insiders, where the transaction is not aimed at securing a benefit from the price sensitive information. It excludes an offence where all the parties had the same information, the trading was limited to the same parties and there was no aim at securing a benefit from exposure to movement of the price of securities.

7.3 This defence may be too wide and too vague a defence. Firstly, one will need to qualify what is meant by "the same inside information". Does it mean that all of the inside information that the parties have should be the same or will it suffice if all the parties share some of the same inside information? Secondly, what is meant by "...the transaction was not aimed at securing a benefit..."? Would one apply an objective or subjective test? If the test is subjective it would be easy for an insider to prove that, subjectively, the transaction was not aimed at securing a benefit, thereby escaping the offence.

7.4 As with the SSA, a corporate can be an insider. This means that if one division of a corporate possesses inside information which another does not and the latter trades, the corporate may be regarded has having committed an offence. A Chinese Wall defence would cure this problem.

7.5 All the offences talk to the securities "which are likely to be affected by [the inside information]". It is noted that it is the **price** that is affected by the inside information, not the securities themselves. Therefore, in sections 80(1)(a), 80(2)(a), 80(3)(a) and 80(5)(a), reference to "securities" being affected, should be replaced with "the price of securities" being affected.

Yours faithfully



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Annexure A

Offences	Defences		Comments
	SSA	**FMB**	
Insider dealing for his or her own account	where the insider was acting in pursuit of completion of an affected transaction in terms of section 440A of *Companies Act, 1973* where a person only became an insider after given the instruction to deal to an authorised user and the instruction was not changed since	where the insider was acting in pursuit of a transaction where all parties have same information, the trading is limited to those parties and the transaction is not aimed at securing a benefit from exposure to movement in the price of the securities (section 80(1)(b)(ii)) where a person only became an insider after he/she had given the instruction to deal to an authorised user and the instruction was not changed since (section 80(1)(b)(i))	This defence may be too wide and too vague. What is meant by the same information? Is the test with respect to securing a benefit a subjective or objective one?
Insider deals for any other person	same as above plus: where the person is an authorised user acting on specific instructions (except where disclosure by that client) where the person acting on behalf of public sector body in pursuit of monetary policy	where the insider only became an insider after he/she had given the instruction to deal to an authorised user and the instruction was not changed since (section 80(2)(b)(ii)) where the insider is an authorised user acting on specific instructions and didn't know that the client was an insider at the time (section 80(2)(b)(i)) where the person was acting in pursuit of a transaction where all parties have same information, the trading is limited to those parties and transaction not aimed at securing a benefit from exposure to movement in the price (section 80(2)(b)(iii))	In terms of section 80(2)(a) of the FMB it is an offence where a person deals for another in securities listed on a regulated market to which the inside information relates or are likely to be affected, and who had knowledge that such other person is an insider. This was not an offence under the SSA. This provision is not problematic as it establishes an offence by persons who deal in securities on behalf of insiders knowingly.

Insider discloses inside information to another person	where the disclosure is necessary for the proper performance of employment, office or profession (unrelated to dealing).	where the disclosure is necessary for the proper performance of employment, office or profession (section 80(4)(b)) (unrelated to dealing).	The defence to this offence do not cover a situation where a due diligence is carried out by a third party bidder (and its team of professional advisors) and the proposed transaction is not proceeded with. It should not be an offence to disclose inside information where disclosure is for the purpose of pursuing an intended transaction, even if that transaction fails.
Insider encourages or causes another person to deal or discourages or stops another person from dealing	No defence	No defence	There is no defence in the FMB (as was the case in terms of the SSA) to an insider encouraging or causing another person to deal or discouraging or stopping another from dealing (section 80(5)). This is harsh. The defence under the *Insider Trading Act, 1998* that the person would have acted in the same manner even without the inside information, should be reconsidered. Another possible defence is that the person only became an insider after, amongst other things, encouraging the other person to deal.

Any person who deals for any other person in securities listed on a regulated market to which the inside information relates or which are likely to be affected, who knew that such other person is an insider	N/A	the person on whose behalf the dealing is done had one of the following defences available: that person only became an insider after he/she had given the instruction to deal to an authorised user and the instruction was not changed since; that person was acting in pursuit of a transaction where all the parties have the same information, the trading is limited to those parties and the transaction is not aimed at securing a benefit from exposure to movement in the price (section 80(3)(b))	