

# Financial Markets Bill, 2012

*Presentation to Standing Committee on Finance*

Presenter: Roy Havemann and Kathy Gibson | National Treasury | 1 August 2012



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA



# Purpose

- Purpose of today is to explain the legislative environment for securities
- Highlight how the Financial Markets Bill fits in
- Next week:
  - Present revisions to the Bill based on stakeholder comments

# Outline

1. The role of financial markets in the South African economy
2. The Financial Markets Bill
  - Purpose, Process, Objectives
3. Policy principles
  - Effective and efficient supervision
  - Financial Stability
  - Protection of investors and clients
  - Other
4. Technical issues

# The context

- *A safer financial sector to serve South Africa better*, announced a number of changes in our approach to regulation:
  - **Institutional architecture of regulation** → Who regulates?  
*Shift to twin peaks*
  - **Strengthening our approach to regulation** → How do they regulate?  
*New banking regulations (Basel 2.5 and Basel 3)*  
*Financial Markets Bill*  
*Credit Ratings Services Bill*  
*Financial Services General Laws Amendment Bill*
  - **Strengthening our approach to market conduct** → How do firms behave?  
*Important that financial services firms must be held to a higher standard (people's savings and livelihoods are at risk, as is the entire financial system)*  
*Consumer protection regime needs to be*

# Process

Date	Event
7 February	Informal briefing on the two Bills
22 May	Formal briefing on Bills
29 May	Public Hearings
4 June	Initial feedback on CRSB
<b>1 August</b>	<b>Parliamentary Workshop</b>
8 August	Final response from Treasury
14/15 August	Consideration of Bills

# Process going forward

Date	Bills	
2012	Credit Ratings Services Bill	<i>G-20 requirements</i>
	Financial Markets Bill	G-20 requirements (OTC derivatives) Update Securities Services Act
	Banks Amendment Bill	Basel III and align to new Companies Act
	Financial Services General Laws Amendment Bill	Annual / Bi-annual bill to update various laws, FSAP etc.
2012/3	Insurance Laws Amendment Bill	
2013	Twin peaks Architecture Bill	Establish new market conduct regulator, shift prudential regulation to Reserve Bank
2013/4	Twin peaks Amendment Bills	Additional update of legislation

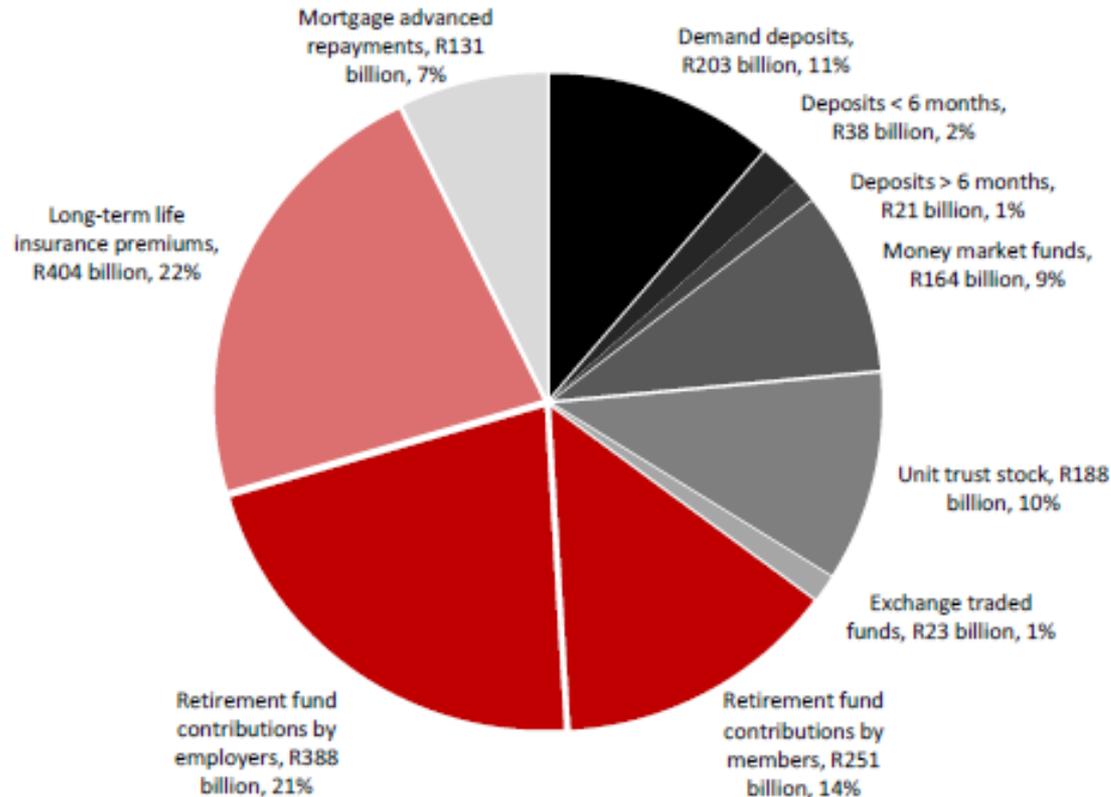
# Capital markets convert savings into growth

## The central role played by capital markets in our economy

- To stimulate economic growth, savings must be converted into investment in the real economy
- Government and companies access capital through capital markets i.e. issuance of equity, bonds, money market instruments and other
  - E.g. annual fiscal deficit is financed from bond market*
- Allows pension funds to invest directly into companies
  - PIC has large holdings in the JSE*
- Efficient (liquid and secure) financial market means more efficient allocation of capital, lower cost of capital, risk management, and effective access to domestic and foreign savings

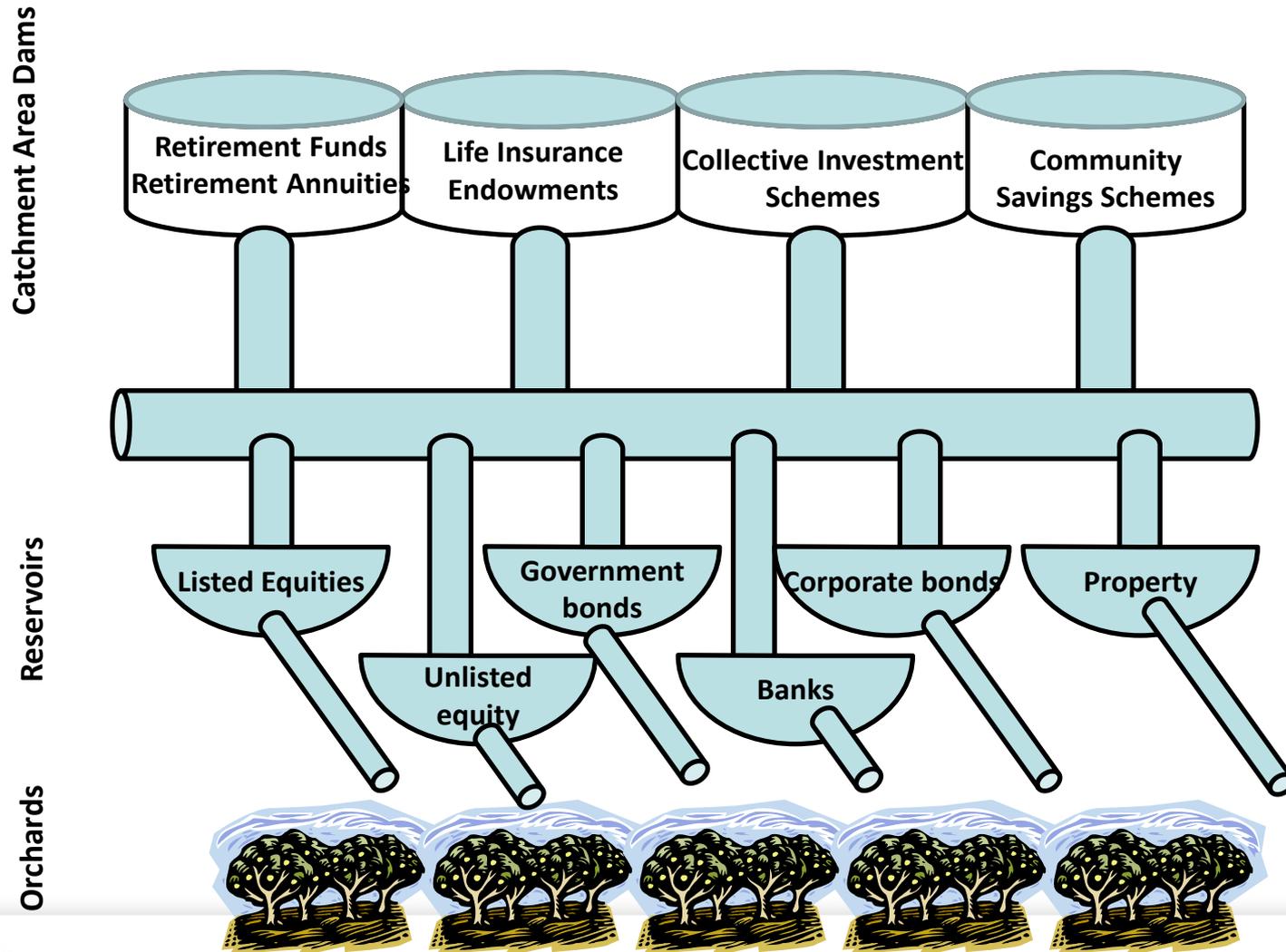
# Savings flow into financial markets mainly from pensions and life insurance

## Flow of savings from household savings, 1999-2010



Source: National Treasury, 2012. *Strengthening retirement savings*

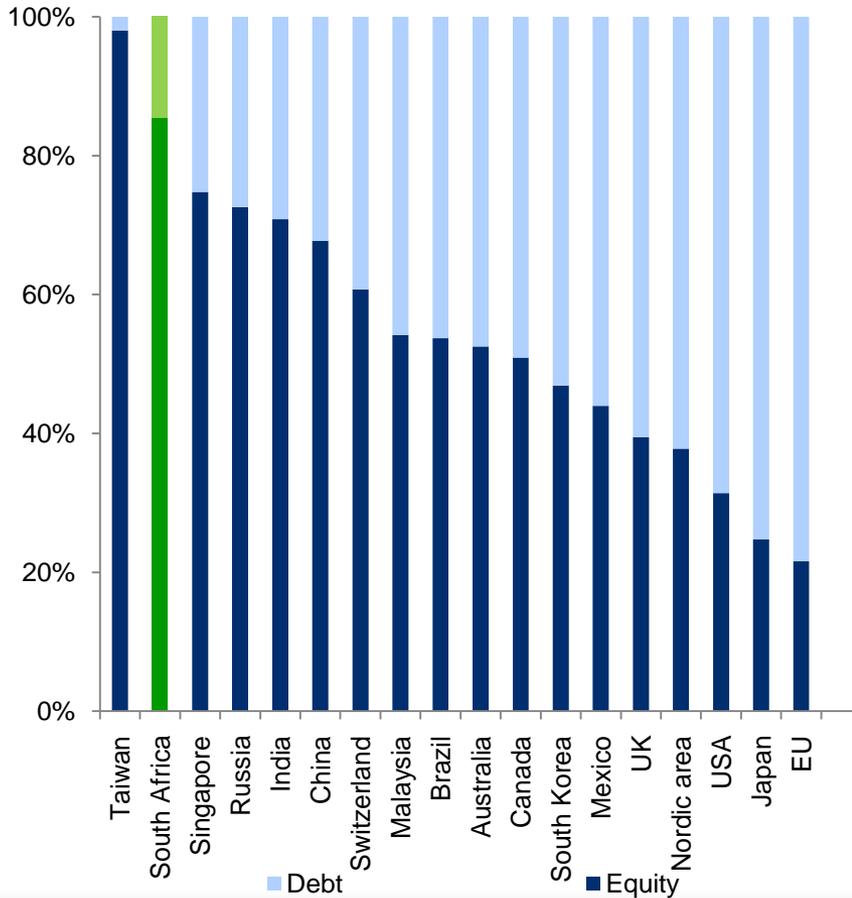
# Financial markets channel savings into growth



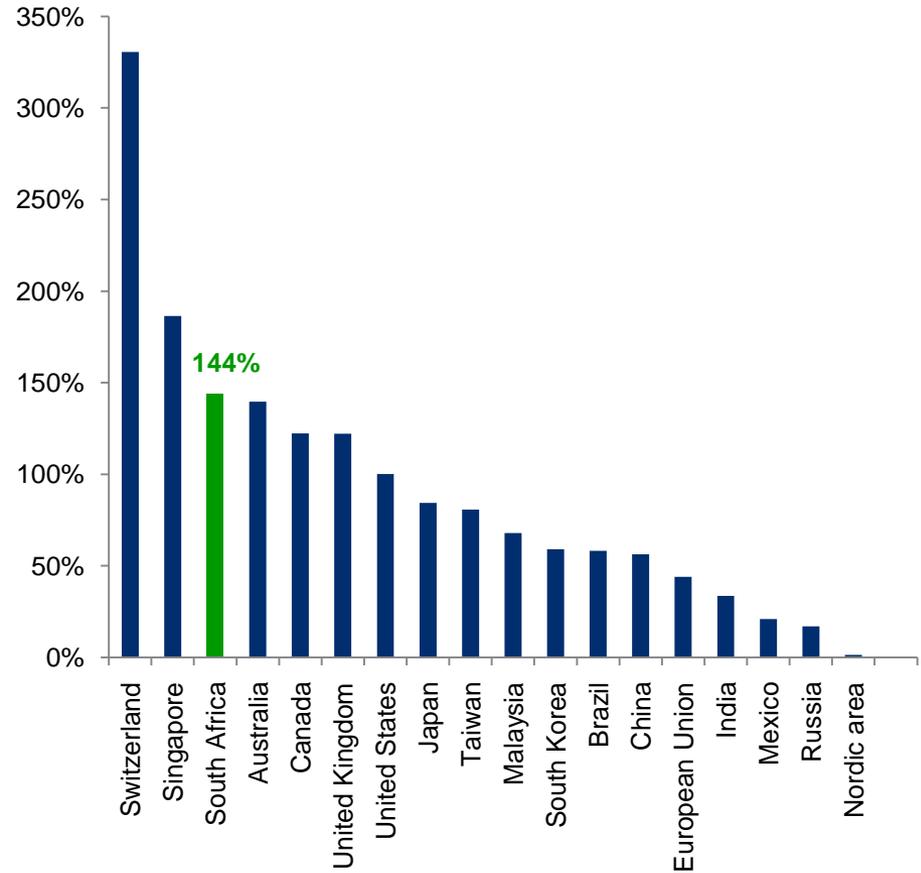
Source ASISA, 2010

# South African capital markets are particularly deep and liquid

## Equity to debt composition



## Equity to GDP



Source: World Federation of Exchanges, BIS & World Bank Data, 2009

# South African regulatory framework is amongst the best in the world

The Global Competitiveness Index	Rank of 142 2011/12
Frequency of banking crises	1 <sup>st</sup>
Regulation of securities exchanges	1 <sup>st</sup>
Strength of auditing and reporting standards	1 <sup>st</sup>
Soundness of banks	2 <sup>nd</sup>
Efficacy of corporate boards	2 <sup>nd</sup>
Availability of financial services.	3 <sup>rd</sup>
Availability of financial services	3 <sup>rd</sup>
Financing through local equity market	4 <sup>th</sup>
Legal rights index, 0–10 (best)*	8 <sup>th</sup>
Strength of investor protection	10 <sup>th</sup>
External debt to GDP	11 <sup>th</sup>
Financial stress index	12 <sup>th</sup>
Ease of access to loans	36 <sup>th</sup>
Affordability of financial services	39 <sup>th</sup>
Venture capital availability	44 <sup>th</sup>

- Strong scores on regulation of securities exchanges, equity market financing, and strength of local equity financing
- Lower scores on ease of access to loans, affordability of financial services and venture capital availability

# Key players in financial markets

1. Providers of market infrastructure  
e.g. JSE and Strate

2. Users of market infrastructure

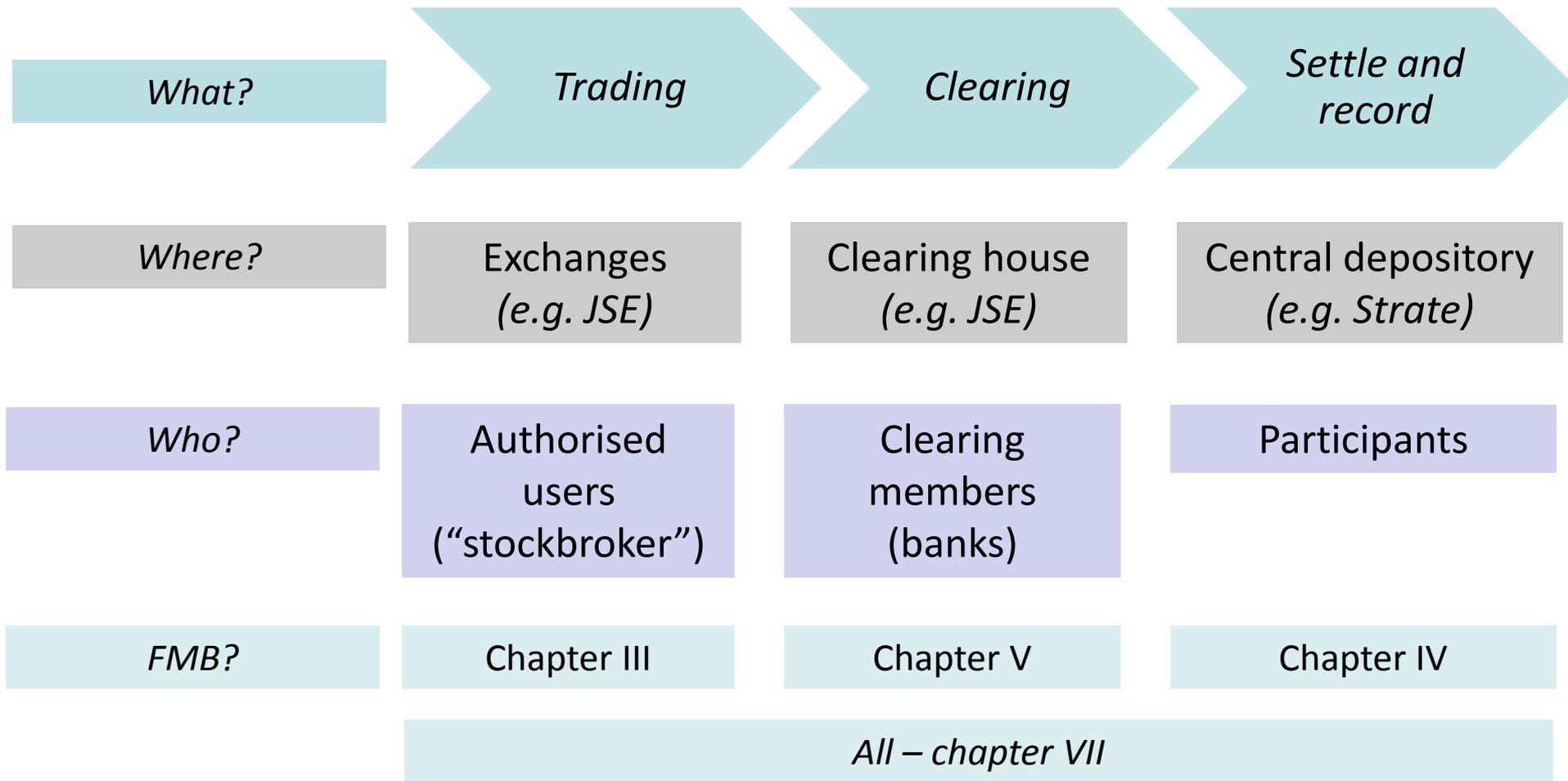
Issuers

Stock brokers (authorised users, participants)

Investors

Important that all players are appropriately regulated

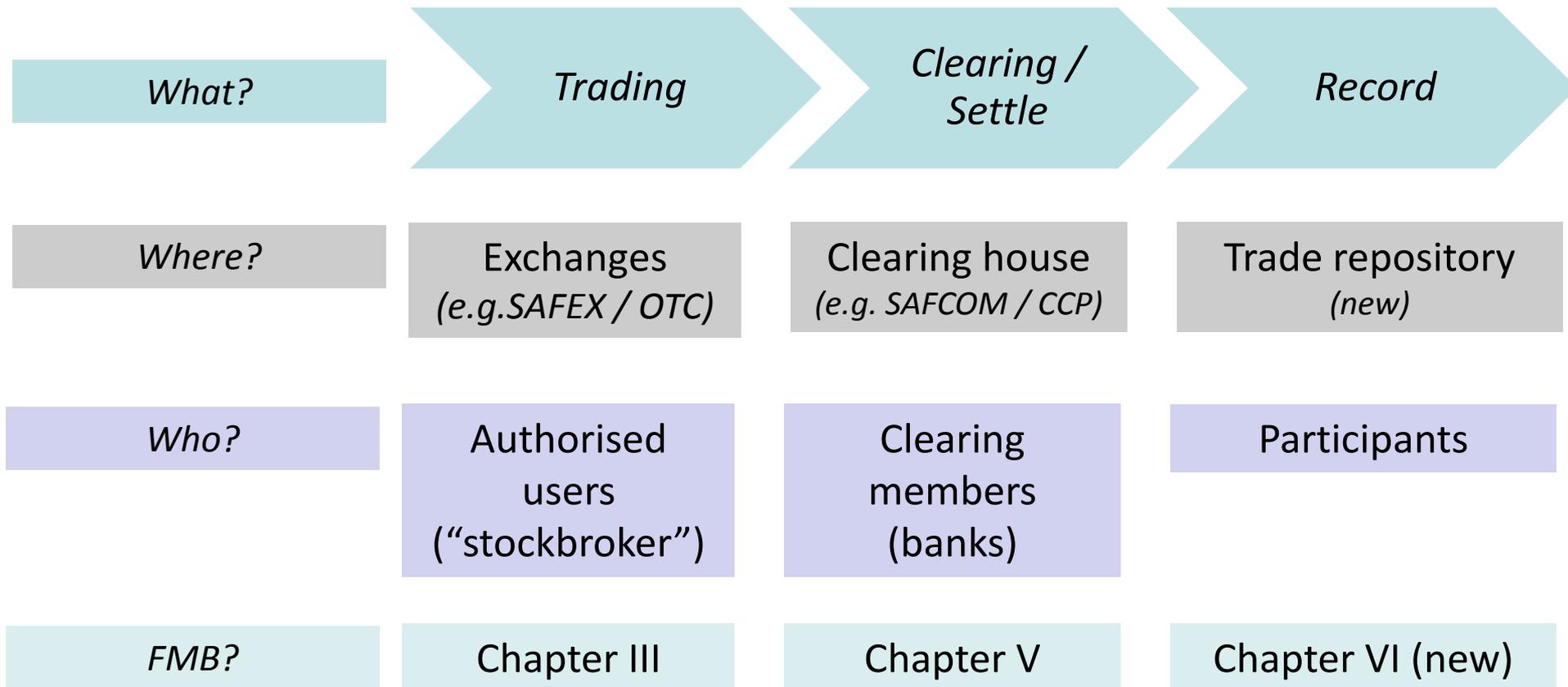
# Who are the main players in the equities market?



# Financial Markets Bill introduces framework for improving regulation of derivatives

- Key lesson of the crisis
- G-20 commitment
- Two types of derivatives:
  - “Exchange traded”
  - “Over-the-counter”
- Introduce a regulatory framework for over-the-counter derivatives
  - See Treasury discussion document  
<http://www.treasury.gov.za/legislation/bills/2012/FMB>

# Who are the main players in the derivatives market?



# The JSE Ltd

- The JSE is one of the top 20 exchanges in terms of market capitalisation and the fixed income market is amongst the largest in the world
- The JSE is a vertically and horizontally integrated, fully electronic exchange offering issuance, trade and post-trade services (vertical) across five markets – equity, equity derivatives, commodity derivatives, spot and derivative interest rate products, and currency derivatives (horizontal)

# The JSE is vertically and horizontally integrated



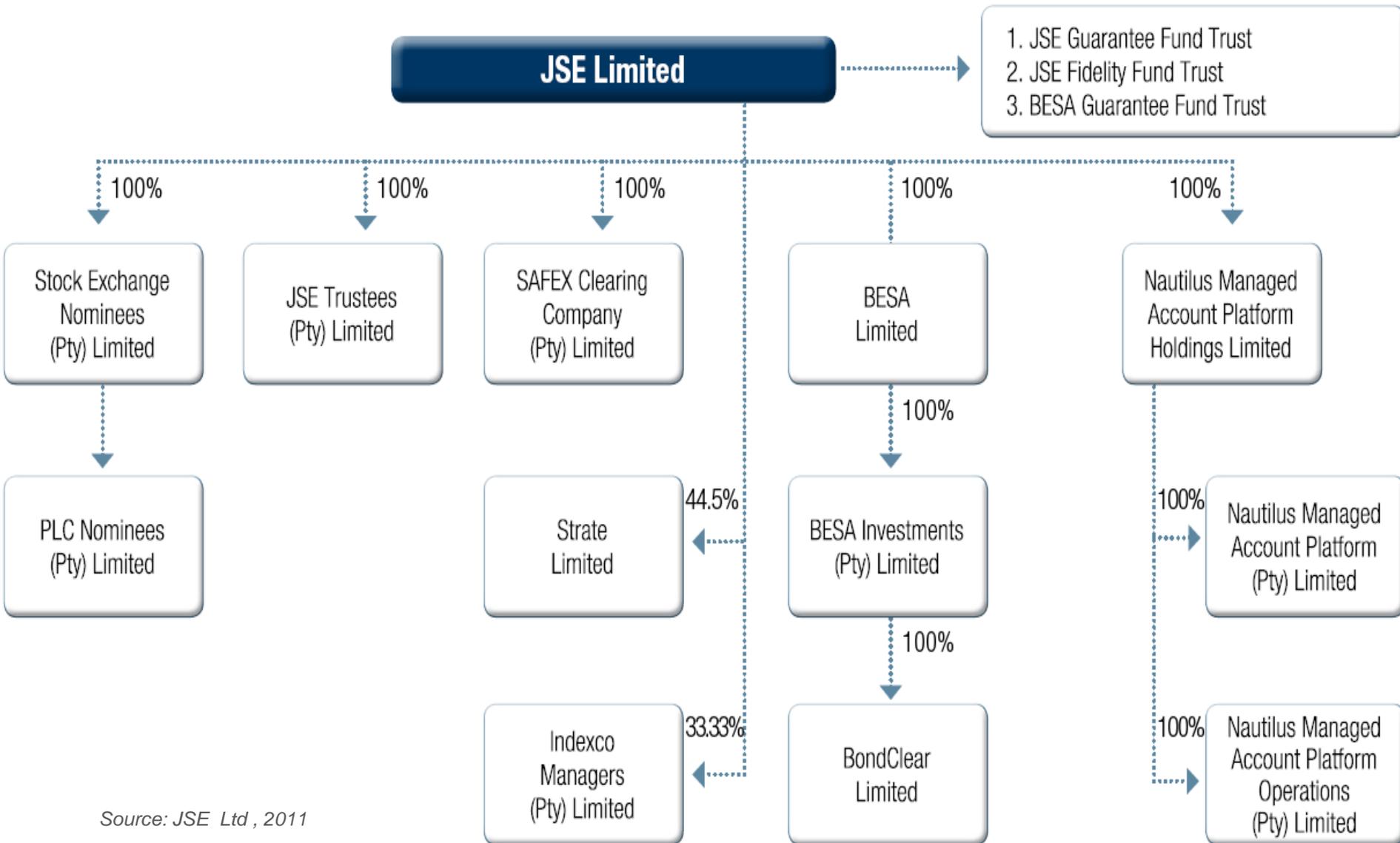
Source: JSE Ltd, 2011



**national treasury**  
Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA



# JSE subsidiaries and investments



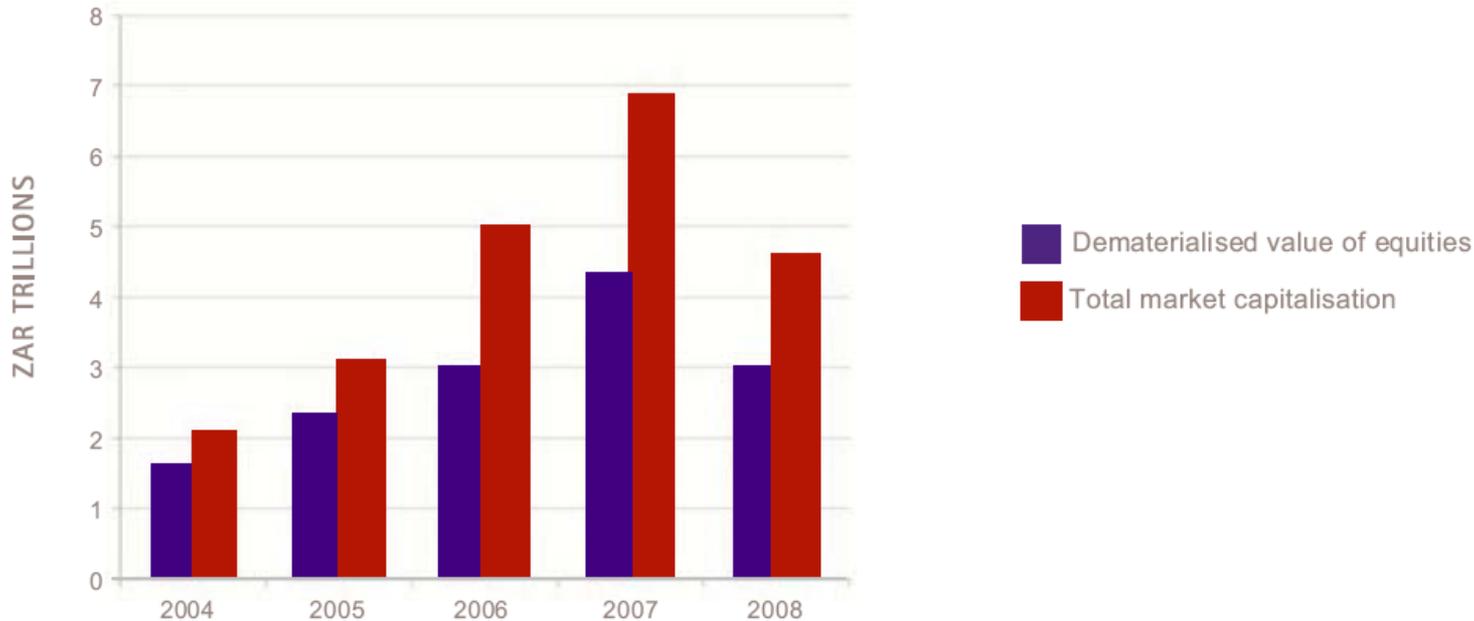
# Strate Ltd

- Strate Ltd is the licensed Central Securities Depository (CSD) for the electronic settlement of financial instruments in South Africa
- Strate also handles the settlement of transactions concluded on the JSE, including equities and bonds, as well as those executed “off-exchange” and a range of derivative products, and money market securities

# Strate Ltd

- Strate's core function is the clearing and settlement of dematerialized securities

## Equities Market – Dematerialised Value and Market Capitalisation

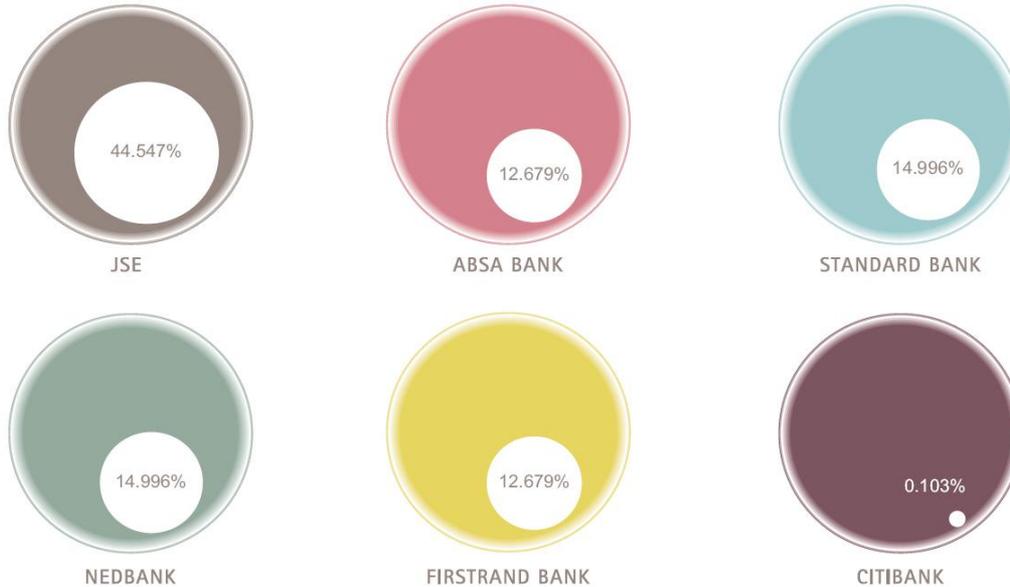


Source: Strate Ltd, 2011

# Strate Ltd

- Strate is owned by the JSE Ltd, the four major South African Banks and Citibank, N.A. :

## Strate ownership



Source: Strate Ltd, 2011

# OBJECTIVES OF THE BILL

# The Bill updates the Securities Services Act

- Repeal & replace Securities Services Act (no 36 of 2004), as amended
- Alignment with International developments
  - G-20 commitments following global financial crisis
  - Financial Stability Board recommendations
  - International best practice: International Organisation of Securities Commissioners
  - IMF and World Bank international assessments (Financial Sector Assessment Program, and Report on Observance of Standards and Codes)
- Changes in principles, laws, e.g. UNIDROIT Convention & international regulatory practices
- Technical/functional issues

# Tabling of the Bill after a long process of engagement

- Securities Services Act Review (2009-11)
- Publication of draft Bill on 4 August 2011
- Comments Received
- Public Forum on 5 October 2011
- NT/FSB/SRO Working Group reviewed comments
- Follow up Treasury-led meetings and correspondence
- Consultative workshops with banks and non-bank financial inst.'s
- Additional meetings with stakeholders including IDBs and PDs
- Submission of the revised Bill to Parliament
- Informal briefing to Parliament earlier this year
- Public forum on 9 May 2012

# Main objectives of the Bill

## Bill aims to:

- Increase confidence in the South African Financial Markets
  - Promote the protection of regulated persons and clients
  - Reduce systemic risk
  - Promote competitiveness of securities services in the Republic
- (Clause 2: Objects of the Act)*

## Achieves this through establishing a framework for:

- Efficient and effective supervision
- Financial stability & mitigating systemic risk
- Investor/client protection, taking into account protection against market abuse

# The structure of the Bill follows these objectives

- Preliminary provisions
  - Definitions, objects of Act (*s 1 and 2*)
- Powers of the Registrar (*s 5*)
- Requirements dealing with the provision of market infrastructure
  - Exchange (*Chapter III*), Central Securities Depository (*Chapter IV*), clearing house (*Chapter V*), trade repositories (*Chapter VI*)
- General provisions applicable to SROs (*Chapter VII*)
- Other matters relating to market infrastructure & its users
  - Code of conduct, unlisted securities, nominees
- Market abuse (*Chapter X*)
- General (*Chapter XI*)
  - Auditing, enforcement

# SSA

Registrar powers detailed, Minister has general powers to issue Regulation (not applied in practice)

No explicit consideration of systemic risk

No requirement for regulatory coordination between regulators

Provides for licensing & supervision of exchange (with integrated clearing function), CSD, associated CH, & respective users

# FMB

Registrar powers expanded (e.g. on-site visits, enforcement committee), Minister explicit regulation-making powers on policy matters (OTC derivatives, direct foreign participation, "new" regulated person category)

Requires reporting of systemic risk to Registrar & Minister

Registrar must coordinate with Governor to monitor & mitigate systemic risk

In addition, provides for licensing & supervision of independent CH (requirements aligned across clearing models) & TR, with respective users

# SSA

SRO regulatory model generally applied

Concept of *financial market infrastructure* absent (refers instead to SROs)

Licensing of exchange/CSD/associated CH requires local presence

Quiet on direct foreign participation in South African markets

# FMB

SRO model retained, conflict & service provider provisions significantly strengthened

Concept of FMI replaces SRO term (although model retained, see above)

Licensing of FMI subject to Minister regulation, no local presence required in the law (although may be required by Minister)

Minister to prescribe how external entities enter SA market

# SSA

Limited oversight of unlisted securities (including OTC derivatives)

Only market players that are "named" can be regulated

Financial stability a policy priority

Limited powers relating to insolvency in settlement chain

# FMB

Minister to prescribe regulatory framework for OTC derivatives

Scope of regulation expanded to ensure full regulatory coverage; Minister can deem any entity to be a *regulated person*

New provisions to strengthen stability, esp. wrt securities intermediation & insolvency (see below on UN Convention)

Alignment to UN Convention on securities intermediation

# SSA

Provides for segregation of assets & client protection

SROs enjoy limited liability in fulfillment of functions; covers both regulatory & commercial role

Alignment to old Companies Act

Quiet on overlapping jurisdiction (by regulators)

# FMB

Strengthening of these provisions

Limitation of liability retained, balanced by stronger accountability provisions (esp. additional business, conflicts of interest, transparency in rules making) & formalised complaints mechanism

Alignment to new Companies Act

Coordination required between regulators which jurisdiction overlaps with Registrar Financial Markets, regulated persons carved out from Consumer Protection Act

# SSA

No direct authority for Registrar for international cooperation (can do so through FSB Act)

Registrar to approve merger/takeover transactions above 15%

Code of conduct for users of exchange/CSD/associated CH

Insider trading a contravention

# FMB

Registrar can enter into MoUs, Registrar can request information from any person

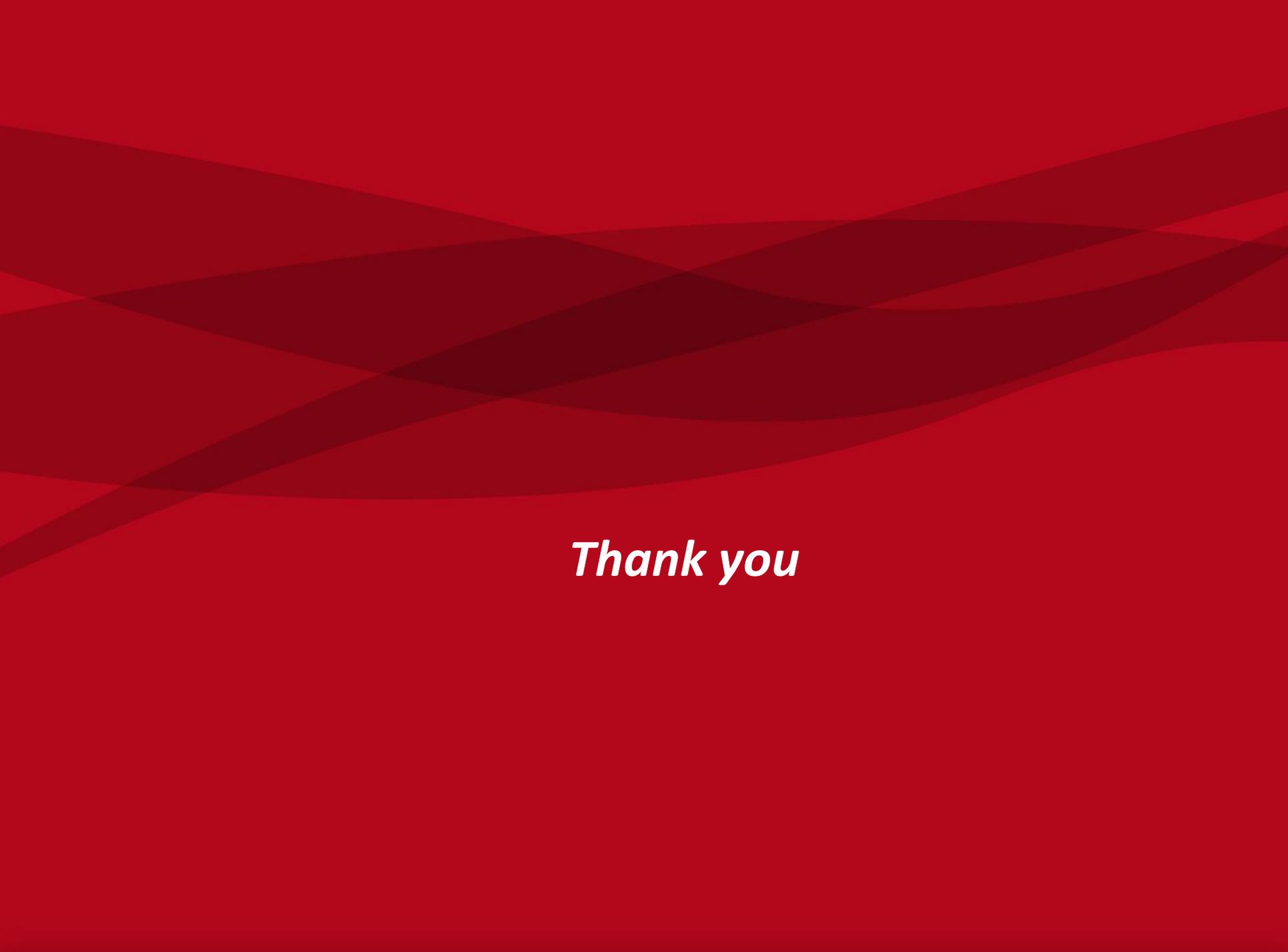
In addition to Registrar powers, Minister to approve change in control

Code of conduct expanded to all regulated persons

Insider trading provisions strengthened

# Big conceptual issues

- **A changing market structure, taking into account the SRO model for regulatory oversight**
  - Do we have it, do we want it, do we need it?
  - Containing market power in an entity that is referee & player
- **Accommodation of an exchange-lite (SRO lite?)**
- **Expand the scope of regulation** – minimise regulatory avoidance/arbitrage
- **A flexible law for a rapidly evolving, innovating market**
- **Preventing a crisis, containing a crisis, minimising loss** – role of the SARB as prudential/systemic regulator?
- **Keeping market participants honest** – curbing market abuse
- **The interplay of cross-cutting laws** – certainty supports stability

The background is a solid red color with several overlapping, semi-transparent dark red wavy bands that create a sense of movement and depth. The bands are layered, with some appearing in front of others, and they curve across the frame.

***Thank you***