EXPLANATORY MEMORANDUM: ANNEXURE A

TREASURY COMMENTS ON ISSUES RAISED DURING THE CONSULTATION PERIOD

TO INFORM THE REVISED BILL, APRIL 2012

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BACKGROUND

Following its approval by Cabinet, the Financial Markets Bill (FMB) was released for public comment on 4 August 2011. This was the result of a 2-year review by the National Treasury and the Financial Services Board (FSB) of the Securities Services Act of 2004 (the SSA), which review included engagement with the Self-Regulatory Organisations (SROs), namely the JSE Limited (JSE) and Strate Limited (Strate). No wider consultation had been done at this stage.

Commentators had until 9 September 2011 to submit their initial comments on the Bill. 17 written comments were received before the deadline, mainly from banks but also including the Self Regulatory Organisations (JSE and Strate), a non-bank participant, private equity firms and asset managers through their respective industry associations, the accounting regulator and one law firm. No issuers commented on the Bill at this time. Comments were reviewed by the Treasury/FSB working group that included representation by the SROs (in their regulatory capacity), and inform the revised Bill. Also taken into account is feedback received from subsequent wider consultation that included:[1]

- A public forum on 5 October 2011 that summarised the main purpose of the Bill and explained the process.
- Follow up correspondence with commentators, led by the Treasury, to request clarification and more detailed explanation on points made in their respective submissions.
- Three workshops held over November 2011 with the banks and other stakeholders, to better understand stakeholder concerns with existing clauses in the Bill, and to provide a platform for open discussion where proposed remedies could be contemplated. *Ad hoc* meetings scheduled as necessary to better understand the views of specific groups of stakeholders, like the primary dealers and inter-dealer brokers.

Highlighting the main issues raised by stakeholders, the document that follows here is a summary response to all feedback received on the 4 August Bill. Notably this report does

[1] A record of meetings is given in Annexure A.1, while a record of commentators is given in Annexure A.2.

not attempt to capture every input made by stakeholders, and focuses on those issues considered most prominent by stakeholders, the regulator and the policymaker alike.

MAIN ISSUES RAISED OVER THE ENGAGEMENT PROCESS

Market structure, including SRO model and Twin Peaks

Comments: Stakeholders argued that with the JSE holding 45% of Strate, control of Strate in effect rests with the JSE, and that this vertical integration has entrenched an unhealthy and anti-competitive market structure.

Commentators questioned whether the regulatory framework provided for in the Bill aligned with the Twin Peaks regulatory model provided for in the Treasury policy document "*A safer financial sector to serve South Africa better*", as both prudential and market conduct regulation were still concentrated in SROs supervised by the FSB.

It was felt that the South African Reserve Bank ("SARB") should have some measure of oversight over certain licensing and registration processes (in particular with respect to the regulation of over-the-counter – OTC - derivatives) since these regulated persons will be regulated by both the FSB and the SARB.

Lastly, some commentators voiced their opinion that the SRO model could be improved as far as the resolution of conflicts of interest is concerned. While calling for this model to be reviewed in this context, to the extent that the SRO model remains, so regulatory requirements dealing with conflicts of interest are proposed should be significantly enhanced (see sections 62 and 63).

Treasury View: The Treasury agrees that the SRO model should be subject to review, especially in light of the broader financial regulatory reform agenda as represented by the move towards Twin Peaks. A formal process will be initiated in 2012, to run concurrently with the Twin Peaks process. Stakeholders are invited to initiate and participate in this review process.

The SRO model and South Africa's capital markets have proven resilient over recent years of financial sector instability and therefore any move away from this regulatory model will need rigorous evaluation. Having said that, potential weaknesses in the existing structure are recognised, in particular as relates to conflicts of interest and engagement processes, and these are being addressed in the manner described in clauses 62, 63 and 72(2) through 72(4) (see the section below for an expanded discussion on conflicts of interest).

Treasury supports the principle of competition provided that it does not threaten the stable functioning of the financial markets. An example of such a threat was seen ahead of the financial crisis where risk management processes were sacrificed in the interests of cutting costs in the OTC derivative markets. Treasury therefore considered including this principle as an object of the Act although decided against it as these competition issues should be adequately dealt with in the Competition Act. Clause 2(e) therefore continues to refer only to "competitiveness". But given the potential importance of this policy objective, stakeholders are nonetheless invited to continue to engage Treasury on how best to support the principle of competition through the governing legislation.

Conflicts of interest

Comments: A second set of comments raised a related concern that the current SRO model may create conflict of interest problems that are not clearly or adequately mitigated. SROs are regulators and for-profit service providers. To the extent that an exchange or central securities depository (CSD) regulates its users while at the same time providing services that compete with those same users, conflicts arise. Moreover as regulator, an SRO must set compliance requirements which may be structured to benefit the SRO in its business capacity.

An example of the first conflict of interest scenario relates to a CSD being required (or not prevented) from providing securities services that compete with its participants, as is feared would be the case in the CSD link-up arrangement proposed (see section entitled, "Direct foreign participation in local market infrastructure"). An example of the second conflict scenario relates to a CSD selling investor data to third parties, information which is required by legislation (and specified by the SROs themselves) to be submitted by CSD participants to

the CSD. Respondents raised the need for a confidentiality or privacy clause that would restrict the use of information to the purpose for which it is provided.

The JSE generates revenue from the exchange traded space. Hence the JSE has a direct, vested interest in any debate about what financial instruments should or should not be traded on an exchange. It is therefore proposed that the Bill should strengthen the decision-making process and criteria in terms of which instruments are required to be traded on an exchange, as well as what new business an exchange may conduct. An independent and robust mechanism is considered needed to ensure that decisions in this regard are taken in the interests of all market participants, and the financial system and economy as a whole. The role and powers of the Registrar as set out in the Bill should be reviewed from this perspective.

Respondents suggested that the Bill provide for a code of conduct binding on SROs to ensure that an SRO does not exploit its position and status to improve the commercial viability of its products and services. In addition respondents asked for public declarations of conflict of interest, an annual reporting requirement showing that there is segregation of regulatory functions and commercial services, a complaints mechanism for complaints against SROs, and an enforcement duty provision.

Treasury View: Engagement on this matter revealed stakeholder concerns to be threefold.

1. Overlap in the provision of market infrastructure by SROs, with respect to regulatory function versus the provision of securities services.

At issue is the lack of clear separation in the existing SSA and the 4 August Bill between the regulatory function required of the JSE or Strate in their performance as SROs, and securities services provided by them as market participants.

The Treasury agrees with this view and as a result has separately defined the concept of function versus securities services across the FMIs (see the definition of securities services, authorised users, clearing house members and participants against the definitions of exchange, clearing house and CSD). An SRO is expressly prevented from providing securities services that would be required to be regulated in terms of its regulatory function, as the

revised Bill provides for an SRO to provide securities services only where necessary to fulfil its regulatory functions – see for example clause 29(1)(s).

To further avoid potential conflicts of interest by SROs as profit making entities versus their roles as "supervisors", SRO rules and listing requirements, including amendments, must be approved by the Registrar, and there are stricter parameters governing new business that an SRO may perform (clause 62). Lastly, clause 63 requires that an SRO takes steps to manage its conflicts of interest, which steps must be transparent, open to public scrutiny and subject to annual self-assessment.

2. Lack of transparency and accountability of an SRO to the regulator and infrastructure users, in particular with respect to rules making processes

The rule-making process of SROs in performing its regulatory functions has been strengthened. SROs are required to formalise the consultation process to be followed in their rules, including who must be consulted and in what manner (clause 72(2)). In addition, rules are to be approved by the Registrar, to which there is opportunity for stakeholders to submit objections. In submitting the proposed rules to the Registrar, the SRO is required to explain to the Registrar the reasons for the rule and any concerns or objections raised on the rule over the consultation process (clause 72(3)(a)). Equivalent provisions apply to an exchange making listing requirements (clause 10(6)).

3. Better adjudication required for disputes between market users and the SROs, and market users and the regulator

Respondents on the Bill were not sure to whom, when they were dissatisfied with the services, products or functions offered by an SRO or if they believed that there was a conflict of interest, they should lodge a complaint.

The banks proposed a formalised procedure to query regulatory and administrative decisions made by SROs, as well as to participate in regulatory design.

In response the Treasury is of the view that sufficient recourse mechanisms are in place for disputes of decisions taken by an FMI in its capacity as SRO on the basis that:

- The Bill provides for strengthened consultation processes to ensure broad stakeholder participation in rulemaking by SROs.
- Any concern by a market user as relating to an SRO can be voiced to the Registrar's office at any time. The provisions of clause 5(3) require that the Registrar take due regard of these, informed by the objects of the Act in particular.
- Administrative decisions taken by an SRO in terms of preventing a user access to the FMI or imposing penalties on a FMI user as provided for under the Bill are subject to appeal under clause 107.

In looking at accountability of the FSB as regulator, relevant given the powers afforded to the Registrar in the scope of subordinate regulation, thought was given to an appeal process to decisions taken by the Registrar in respect of regulatory design as well as administration of the law once it is implemented.

With regards to subordinate regulation, while a rigorous and transparent design process is necessary, once the regulation is implemented it cannot - and should not - be "appealed," unless there are substantive legal grounds for appeal, like constitutionality, for which appeal mechanisms already exist. Ideally concerns should be voiced over the engagement period preceding implementation.

Treasury strongly supports transparency and accountability in the drafting of subordinate legislation, which processes should be subject to legal review. However this is not an issue isolated to the financial markets regulatory framework and therefore should, and will, be considered within the broader review of governance arrangements within the FSB already underway. It is therefore premature to introduce any changes of this nature through this Bill.

Moreover the responsibility for subordinate regulation that is considered to have significant policy and economic consequences, in particular as regards the regulation of OTC derivatives and of foreign participation in South African markets, is now proposed to vest with the Minister rather than the Registrar (issued through regulation - see clause 5(6) and 77(1)). Naturally, the Minister is obliged to follow due process of law in this regard.

Lastly consultation forums can be provided for on an *ad hoc* basis, as proposed by certain banks to facilitate engagement, but this does not need to be legislated for.

In terms of administration of the law, clause 107(1)(a) provides for the right of the appeal, which appeal process is governed by section 26 of the Financial Services Board Act.

Consultation and adjudication processes

Comments: Respondents argued for a more robust consultation period with regards to amendments to the listing requirements of an exchange, including that the proposed amendments be published on the official web site of the exchange for the duration of the objection period, to enable interested parties not previously consulted by the exchange to review the proposed amendments and object, if appropriate.

It was proposed that provision be made for a process to review and appeal decisions of the Registrar in respect of the Registrar's powers and responsibilities in the Bill. A review process within the ambit of the FSB is considered more efficient and accessible than relying on the provisions of the Promotion of Administrative Justice Act, 2000. It is suggested that this appeal mechanism have an arms-length relationship with the Regulator, along the lines of the mechanism provided for in the Banks Act. This mechanism could be strengthened by including rules or guidelines for the review process and the adjudication of reviews in regulations pursuant to the new Act.

Treasury View: Engagement with stakeholders revealed that transparency in consultation processes is relevant in three scenarios: SRO rulemaking and the setting of listing requirements, approval for additional business that can be conducted by SROs, and the way in which the FSB promulgates subordinate regulation and takes administrative decisions in conducting its supervisory role.

Of these, the process for setting rules and listing requirements has been dealt with above. On the matter of additional business, it is not feasible to require consultation on proposed business by SROs as this would result in undue interference with the day-to-day operational running of the SRO businesses. It is believed that clause 62 read with clause 63 gives adequate protection against potential conflicts, further supported by clause 107(a) which gives aggrieved stakeholders the right to appeal the Registrar's decision in this regard. Lastly, on the matter of holding the Registrar to account, we refer to the discussion in the

preceding section. It is important to clarify that the mechanism under the Banks Act[2] that is referred to does not allow for an appeal of the subordinate regulation, but rather a review of decisions made by the Registrar in terms of that Act and regulation. This is essentially equivalent to the appeal provisions already existing within the FSB, as provided for under this Bill and the FSB Act.

Expanded scope of OTC derivatives regulation, to include proposed stand-alone clearing house and reporting to a trade repository

Comments: Issues raised by industry include - the extended scope of the regulation and whether powers afforded to the Registrar are too great; whether a trade repository is necessary given that the focus is on reporting and this could be done through other channels (e.g. building on existing bank returns); what will be done with the detail submitted and by whom; and who will fund the new infrastructure.

Respondents felt that there was insufficient certainty provided on the types of OTC derivatives that will need to be cleared or reported to trade repositories. This was considered especially important because of the high amounts of incremental margin that would be required to protect against incremental exposures under similar legislation like the Dodd-Frank Act in the United States. Concerns related to increased costs to market participants to trade in these instruments and the potential impact of such on liquidity and therefore price efficiency. A point was also made about principal-to-principal transactions of OTC derivative instruments that do not fall within the ambit of the Financial Advisory and Intermediary Services Act, 2002 and therefore pose a gap that should be addressed through the envisaged regulation.

Treasury View: In line with South Africa's G-20 commitments, the scope of regulation will be extended to include OTC derivatives. Details are provided in the accompanying discussion document. Informed by recommendations made within the G-20 and IOSCO forums, it is imperative that the regulatory framework supports the regulators and policymaker in identifying and responding to risks emerging out of OTC derivative markets in South Africa, as they may impact on the stable, effective, and efficient functioning of our financial markets in general. The intention of the Bill is therefore to give effect to this policy, by

[2] Section 9 of the Banks Act

enabling the design of appropriate regulatory requirements that govern the way in which these instruments are traded and reported. In addition to supporting increased transparency to both the regulator of financial markets and the Reserve Bank of developments in this market, this will also ensure increased transparency for market participants to support risk management.

The Treasury acknowledges concerns that the Bill is silent on which instruments will be regulated and how. The decision has been taken to define these requirements in subordinate legislation for the following reasons:

- The Treasury prefers a principles-oriented approach to legislation that provides flexibility for a rapidly evolving market; and
- The regulatory approach to these instruments needs to be flexible and adaptable and is expected to change over time. One does not want to revise the Act each time the requirements for OTC derivatives are amended.

However given the significant policy and economic implications that regulating the OTC market will have, National Treasury proposes that the responsibility for the regulations vest primarily with the Minister (see clause 77(1)), who will follow the required regulatory design process in accordance with the provisions of the Promotions of Administrative Justice Act, 2000. The Treasury also commits to an economic impact assessment of the proposed regulatory framework to ensure that it delivers on the policy objectives spelled out, at a reasonable cost to the regulator, market participants and the financial and corporate sectors. The Registrar will be responsible for giving effect to this regulation through operational requirements and oversight of such regulation (clause 77(1) (a) through (d)).

Comments: There was concern about a trade repository being a for-profit organisation, as it would be charging fees for information that market participants were required to report, leading potentially to conflicts of interest. It was also felt that clear reporting requirements on market participants should have been given in the 4 August Bill, and that the increased transparency from a trade repository as a value proposition needs to justify the cost of this transparency. It was proposed that a new clause be introduced to deal with the control of confidential information in the trade repository, in particular information that would reveal market participants' trading

strategies, but also confidentiality which could alert the market to material price sensitive non-public information and the timing of publication of that data.

Respondents expressed the need for sufficient time to be afforded to authorised users and participants to align to new reporting requirements, and for cognizance of aligning information requirements with those of international trade repositories. Outsourcing of trade repository functions was felt to be problematic in the sense that the only safeguard was approval by the Registrar. In sum, certain banks view it premature to put trade repository provisions in the Bill, arguing that the definition of this infrastructure is overly broad and would unintentionally capture many regular operational reporting type systems/activities.

These considerations aside, in noting the underlying rationale of reporting trades and exposures through to a trade repository – namely improving transparency in the OTC derivative market, mitigating systemic risk, and enhancing the integrity of the markets by strengthening protection against market abuse - many banks expressed support in principle of a trade repository. However these banks pointed out that a trade repository itself would not achieve these objectives, and highlighted the importance of the trade repository being designed in a way that would ensure delivery of the value it is expected to bring. For example, clarity was requested on how the authorities would go about using the data from a trade repository to wind down systemically important but non-viable financial institutions. If these critical linkages were missing, the policy objectives underpinning the regulation of OTC derivatives would not be achieved.

Treasury View: In line with G-20 commitments, the reporting of OTC derivative trade data to a central point is considered an important pillar to South Africa's reform strategy. While agreed that a trade repository in itself will not mitigate systemic risk, central reporting is seen as a crucial first step to better understanding the size, scope and behaviour of the market to inform a future reform agenda (as relates to which products should be subject to more stringent regulatory requirements), and help in the meantime to monitor systemic build up across these market segments, to promote a proactive response to such by the policymaker and regulators.

In response to whether central reporting could happen through existing reporting channels, for example by extending the BA350 returns, the Treasury considered this would be inadequate. Firstly, the purpose of these returns is the microprudential regulation of banks, and therefore necessarily has a different focus from one on the OTC derivatives markets. Secondly, the Bank

Supervision Department under the Registrar of Banks does not have the mandate for monitoring derivative activity outside of activity that affects banks. Third and most important, if designed and managed correctly a trade repository is considered the most cost efficient and effective way in which to record and centralise data.[3] Essentially just a "system," the component parts can be tailored to ensure that only relevant information is collected, and that such information avoids duplicate reporting, is treated with the correct degree of confidentiality, and is used in the most efficient and effective manner to assess systemic risk and financial stability, and improve market surveillance, supervision and enforcement.

However as explained in the OTC derivatives discussion document, there remains much work to be done in assessing what the model for a trade repository should be. In particular, the paper considers at least the following matters to be addressed:

1. How should the regulatory framework provide for establishing a trade repository? To what kind of oversight should it be subject? Who will exercise that oversight?
2. What should be the trade repository's role and responsibilities and how should its function be defined?
3. What should be the trade repository's structure and financing?
4. How will the trade repository fulfil the policy objectives underlying such mandatory reporting, namely the assessment of systemic risk and financial stability, market surveillance and enforcement and market supervision?

The provisions in the Bill that relate to trade repositories, found in chapter VI, respond to item 1. The Treasury considers that this is necessary to give effect to its policy determination explained above – that specified OTC derivatives data must be reported centrally to a trade repository[4]. While not an SRO, provisions are consistent with the other market infrastructure sections by providing for the licensing requirements and process, as well as the minimum duties (instead of functions, as is not an SRO) that the trade repository

[3] Implementing OTC Derivative Market reforms, Financial Stability Board, October 2010 (http://www.financialstabilityboard.org/publications/r_101025.pdf)

[4] As noted by a number of respondents, data is already collected by the Bank Supervision Department, the JSE, etc. However, data collection is fragmented. In essence the TR will centralise the collection of data to one place, and may for instance report it to the Reserve Bank Financial Stability Committee, which will ensure that the data is utilised to identify and respond to potential systemic risks.

would be expected to perform. The regulatory framework for OTC derivatives as laid out by the Minister will then give guidance to the exact regulatory model of trade repositories in South Africa. As a first step Items 2 through 4 above are explored in the discussion document. It is not considered appropriate to specify much of this detail in the Bill. For example, one can contemplate different trade repositories for different market segments, and these may be supported by differing ownership or balance sheet/income structures. The Bill must be sufficiently flexible to provide for these alternative arrangements. Also, specifying what should be reported and how frequent is likely to change over time, and therefore warrants the flexibility of subordinate regulation. In any event the Treasury and FSB will continue to engage on how best to implement Bill provisions, and the trade repository proposals will likewise be tested as part of the OTC derivatives regulation economic impact assessment.

Lastly, in responding to additional comments made:

- Confidentiality provisions have been tightened as proposed, although through a principles rather than rules approach (see clause 57(1)(f)); subordinate regulation will specify the exact parameters regarding confidentiality.
- It is not agreed that outsourcing provisions should be limited in the Bill; outsourcing of any duty by the trade repository in no way diminishes the responsibility of the trade repository and trade repository management for that duty.
- Market participants are assured that an adequate phase-in period will be applied, although this is not (and cannot) be specified in legislation.[5]
- The Bill is intentionally quiet on the domain of the provider of the envisaged trade repository, i.e. it is not prescriptive on the degree of presence the trade repository system or the provider of the trade repository system must have in South Africa. However in satisfying licensing requirements, in addition to proving sound management of operational and financial risks associated with being off shore, the Registrar will need to be satisfied of his or her powers and authority to regulate a foreign provider, and hold such entity accountable should it fail to live up to licence requirements.

[5] Under clause 5(3) the Registrar cannot apply any rule or requirement that may destabilise the market; this would include too rapid implementation of system changes.

- As the trade repository regulatory discussion evolves, the issue of aligning the reporting provisions for listed instruments traded off exchange with that of OTC derivatives will be considered. It is not however considered necessary to stipulate this in the Bill – clause 24 provides adequate flexibility to accommodate this alignment over time.

Comments: With regards to the provision for an independent clearing house, some respondents argued that multiple clearing houses would not provide increased efficiencies or significantly reduce counterparty risk, and that a single clearer would provide maximum offset of risk through the use of multilateral netting arrangements. Other respondents suggested that banks and other market participants should not be required to underwrite the clearer as is currently the case, but that one clearing house be supported by its own capital. This would prevent banks from putting their balance sheets at risk in support of a clearing house and putting depositor funds at risk in the process. It was further proposed that the Bill should clearly spell out that any new clearing house should only be for the clearing of derivatives and not for other securities.

Treasury View: The existing regulatory framework – given effect through the SSA – presents a view of clearing houses which has accommodated the existing market infrastructure environment, but does not fully reflect Treasury's policy perspective. It presumes that clearing houses are necessarily linked to an exchange, and related to this are not afforded SRO status. On the other hand, in the context of global financial instability blamed in part on bilaterally traded and risk-managed OTC instruments, central clearing for OTC derivatives has become a policy priority for most countries, as represented through the G-20 and IOSCO. The Bill therefore aligns to government's intention to allow a market environment that can fully respond to the global reform agenda underway.

Stakeholder representations that the Bill should restrict the number of clearing houses across market segments, is considered unnecessary and inappropriate. Any new license application would need to prove system compatibility with the existing trading, clearing and settlement systems, and could not introduce systemic risk. On the other hand, the market participants should be given the flexibility to introduce new or alternative clearing arrangements should this be deemed as necessary or desirable.

Likewise it is not agreed that the market is ready for the clearing house model to be prescribed, as relating to whether risk should be borne on the balance sheet of clearing members or that of the clearing house itself, and linked to this discussion whether clearing of OTC derivative products is better provided by a domestic or foreign infrastructure. It is expected that this discussion will evolve over time, but compelling a model at this time may introduce market disruption.

Other matters relevant to the regulation of OTC derivatives

Comments: Clause 77(2) of the 4 August Bill relieved a counterparty to an OTC derivative transaction from all obligations should the other counterparty contravene any provision of the Act, thereby potentially introducing systemic risk.

Treasury View: The intention of this clause was to protect the counterparty to the unlawful transactor, and should return both parties to the position that they were in before the transaction was agreed to, without disrupting the market. The Treasury is in agreement with commentators that this clause is phrased overly wide and could have unintended systemic consequences, and therefore has been deleted. The parties involved should dissolve the transaction through legal processes available.

Comments: A clear and mandatory code of conduct and reporting obligations should be provided with regards to all persons who enter into OTC derivative contracts (as opposed to only those entities providing securities services in respect of those OTC derivatives).

Treasury View: The Treasury agrees with this principle. It is intended that the policy approach agreed by Treasury will be implemented through regulation, as provided for in clause 76(1).

Direct foreign participation in local market infrastructure

Comments: Stakeholder engagement revealed three scenarios that need to be considered: CSD link-up i.e. a foreign CSD as a participant in Strate without a local company or balance sheet; other foreign persons as participants or authorised users without a local company or balance sheet; foreign participation as a market infrastructure provider, and by implication an SRO, with or without a local presence or balance sheet.

- On the scenario of a CSD link-up most CSD participants reflect in principle agreement with Strate proposals, but remain cautious as to how it will be implemented. Some stakeholders expressed concern that CSD link-up could introduce new risks into the system, and unless the arrangements are well defined in legislation the CSD could start to compete with its participants. It was felt that link-up could be anti-competitive should market participants be required to use the CSDPs to do cross border transactions. Multiple market participants should instead be allowed to connect to other depositories and should not have to be channelled via the CSD. It was also mentioned that transfer agents have a vested interest here as they have successfully been the only parties doing cross-border share deliveries for multi-listed issuers for the past 50 years.

  In a workshop on the 4 August Bill with the banks it was proposed that legislation should provide for a new category of participant and that rules are prescribed regarding what the entity will and will not be able to do.

- On the scenario of remote membership stakeholders across the financial markets reflected concern about the enabling provisions, as may relate to bringing new risks into the system. Introducing foreign membership allows firms of unknown or uncertain reputation to operate locally where, as with any financial market, the sound reputation of the participant firms is a key pillar of the soundness of the system. Relatedly questions were asked about regulatory jurisdiction and the (in)ability to get into a strict and enforceable contract with foreign-based market participants. Lastly, Inter Dealer Brokers observed a threat of unqualified access of foreigners into the South African market and about existing foreign entities located here possibly relocating off-shore, questioning whether this supported the concept of "SA Inc."
- On the scenario of foreign provision of market infrastructure, market participants generally supported the need for having a local presence to ensure tight regulatory oversight and certain jurisdiction. However clearing houses and trade repositories were singled out as possible exceptions. Related to the discussion on the regulation of OTC derivatives, requiring a clearing house of these instruments to be domiciled in South Africa presents a challenge given the structure of the SA market – in particular

the concentrated banking system. In this instance some commentators proposed that a foreign provider, netting exposures from around the world, would balance the dangers related to weakened regulatory oversight and jurisdiction with significantly more diversified clearing risk.[6] Some commentators also proposed that the integral role of certain foreign entities to the international debates and system design of trade repositories may position these entities well to run a South African trade repository. The banks advocated strongly that policy decisions on these matters be incorporated into the Bill. For example, it was suggested that the Bill clarify the situation with respect to internationally-established and regulated clearing houses, in particular whether these could parachute into South Africa using their licences issued in other jurisdictions as a 'passport,' or whether they would need to re-apply to the FSB.

Treasury View: The Treasury agrees with the view that the 4 August provisions relating to foreign participation may be premature, and that insufficient guidance is given in the Bill to fully reflect its policy view. While a policy decision has been made to allow direct foreign participation in our markets, it is believed that this should be phased-in over time, and regulatory requirements are expected to differ across the sub-categories identified above. Significant consideration must be given to the impact of opening up our markets on its efficient and stable functioning.

Over the course of engaging with stakeholders, Treasury considered whether to remove these provisions on the basis of potential risks that need to be further explored. However upon review it is not considered sensible that certain sub-categories of foreign participation are legislated for – namely the CSD-link up scenario – while others are expressly prevented. Also, flexibility should be granted for differing requirements for foreign participation where the risks to the system differ. For example, while it may be considered generally desirable for SROs to have a local presence, the clearing of OTC derivative instruments may be more risk-friendly should this function be provided by an entity with an off-shore balance sheet,

[6] Permitting foreign clearers, known as satellite clearers, within the current market structure could still increase systemic risk if clearing members are ever required to put their balance sheets at risk to support the clearing house. This could be the case if the creditworthiness of the satellite clearer is not well understood or doesn't meet stringent requirements, and a subsequent failure requires the standing in of local market participants to fulfil clearing obligations.

instead of concentrating risk onto the balance sheets of local banks. It is therefore proposed that the Bill allows for direct foreign participation in our markets subject to regulation prescribed by the Minister (as per the new clause 5(6)). In recognition of the risks to regulatory supervision and enforcement that direct foreign participation in our markets may imply, it is imperative that regulatory requirements be determined by the executive in a manner consistent with broader financial sector and economic policy.

The Minister, through the Treasury, will engage the industry on its appetite for foreign participation, and the requisite regulatory parameters that should be laid down. It is anticipated that the Minister will enable certain categories of foreign participation over time, but at the outset will require a local presence, to be defined. No opening up of the market should be pursued without an economic impact assessment, focusing on the financial sector and capital markets specifically.

On the link-up scenario specifically and concerns about an anti-competitive market structure, market participants will not be required to trade through this system. The existing channels for cross-border transactions should remain and link-up could serve as an alternative by potentially granting improved efficiencies and risk mitigation through increased transparency to these transaction flows.

SRO License applications

Comments: Stakeholders made the point that the SRO structure itself purports a significant barrier to entry, as an applicant must have the operational and regulatory resources necessary to perform this role.

A related issue is that the definition of clearing house and CSD in the 4 August Bill was linked to the functions that these entities are required or permitted to perform (in terms of clauses 30 and 50). An entity performing any one of these named functions would as a result be inadvertently captured by the definition, and by implication would require a licence.

Treasury View: As discussed in the section entitled, “Market structure, including SRO model and Twin Peaks”, the SRO model will be comprehensively reviewed but any changes will not be incorporated in this draft of the Bill. The far-reaching impact of this approach is noted

and will be revisited as part of the Twin Peaks review process already underway. It is however agreed that the 4 August structure for SRO licensing requirements could be clarified and the definitions refined to ensure against the unintended consequence that market participants are compelled to get a clearing house, trade repository or CSD license by virtue of performing relatively innocuous and regular securities services. The reader is thereby referred to the respective SRO definition and licensing clauses – new clauses 6-8, 26-28, 46-48 and 54-56.[7]

GENERAL COMMENTS RELATING TO EXCHANGES

Central Order Book Trading

Comments: There was concern about the wording of the Explanatory Memorandum to the 4 August Bill which stated that all orders made by authorised users of listed securities, should "be executed on the exchange trading system." It was suggested that it was difficult to interpret clause 24 of the FMB in this way because there was no specific mention that orders by authorised users should be executed on the exchange trading system.

Treasury View: The clause is not intended to imply that the exchange implements a rule that would force all its authorised users to execute orders of listed securities on the exchange trading system. The word "execute" here refers to the reporting of trades to the JSE. It is important because a trade is only considered a "transaction" or "contract" once it has been reported in this way to an exchange (this clause should be read in conjunction with the definition for an exchange).

GENERAL COMMENTS RELATING TO CSDs

Securities Ownership Register (SOR) (clause 26 of August Bill, new clause 25)

Comments: There was concern about the CSD being given authority, through an SOR, to obtain information and conduct activities that effectively allow it to compete directly with the participants that it regulates. Respondents felt that this was important to raise in the

[7] The corresponding clauses in the 4 August Bill are 7-9, 27-29, 47-49, and 55-57.

context of a vertically integrated, CSD-owned SOR, which structure was argued to worsen potential conflicts of interest in that arrangement. Related, it was proposed that the CSD should not have jurisdiction over the certificated environment, but should only regulate securities that have been dematerialised. In considering the policy document that supported the 4 August Bill, issue was raised regarding the scope and appropriateness of the international examples cited, noting that attention should be given to the unique ownership and regulatory structure in the South African case, notably that of being vertically-integrated SROs.

Treasury View: The concept of a central register at the upper most tier of the CSD is a policy priority in order to increase real-time transparency – and therefore visibility - of securities ownership. Not only will this be an important risk- management and monitoring tool, but over the longer term can inform policy regarding the financial sector in general and government debt-issuance in particular. The CSD will not have unlimited authority to impose requirements on market participants relating to the SOR, as requirements must be consistent with the function of the SOR, as determined by the Registrar. Note that the Registrar must approve all rules according to the legislation (see clause 72). Further, to be an effective and complete central register, all ownership records should be placed in the dematerialised environment. However the Treasury is sensitive to concerns raised over the concentrated ownership structure of the FMIs, and will be assessing the impact of this on the financial markets in the near future (see section entitled, "Market structure, including SRO model and Twin Peaks". In the meantime, greater attention will be paid to manage and mitigate arising conflicts of interests, as already discussed.

Securities ineligible for deposit (Clause 32 (a) of August Bill, new clause 31 (a))

Comments: Clarification was sought on what should happen if securities are not eligible for deposit into a CSD due to a decision by the depository not to accept such securities for deposit. This was asked on the grounds that clause 32(a) of the 4 August Bill stipulates that a participant must, if securities are deposited with the participant, deposit them with a CSD.

There was also concern that the clause seems to be inconsistent with the right of a client to rematerialise his securities as provided for in clause 35(h), because an owner of securities may want to rematerialise his shares but still keep them with the CSD participant. The CSD participant however would not be able to deposit the rematerialised shares with the CSD because the CSD does not accept those rematerialised shares for deposit.

Stakeholders queried the apparent inconsistency in clause 35(j) that makes provision for the CSD to refuse to accept securities issued by a particular issuer.

Treasury View: Uncertificated securities can only exist in a controlled CSD environment where the CSD is the highest level in the securities holding chain, reconciling its holdings with the CSD participants and other intermediaries below. If the CSD is not involved, there is no direct link between the issuers and the CSD and the necessary reconciliation of the share capital of an issuer cannot take place with the CSD. The SSA has always prescribed the CSD obligations *vis-a-vis* the issuer in that Act. The CSD participants cannot keep uncertificated securities without depositing them with the CSD. At the same time the CSD is responsible for regulating and supervising the uncertificated environment with regard to for instance holdings and corporate actions, and must for these reasons control what is eligible for deposit.

There is a process in which issuers become eligible and sign a "contract"/application form that they will be bound by Strate's rules and directives. The JSE listing requirements also prescribe that the listed companies must adhere to the Strate process with regard to eligibility. Clause 32(a) – new clause 31(a) - is therefore retained.

Revocation of settlement instructions (clause 35(2)(u) of August Bill, new clause 34(2)(u))

Comments: The revocation of instructions at any time on or before insolvency (e.g. 1 hour before insolvency) may cause substantial practical problems, in particular where instructions will be netted, processed in batches or subject to settlement cycles, because the unwinding of a single transaction at that late stage may cause systemic risk.

Treasury View: The amended wording in clause 34(2)(u)(ii) works with (i) and is not an alternative to (i). Sub-clause (i) deals with what the market knows as "contractual

commitment," where in normal circumstances there is a set time in the cycle where CSD participants contractually commit to the transaction on behalf of their clients and cannot pull out after this time. The CSD directives prescribe this already and exceptions are allowed in only very specific circumstances as prescribed in the particular directive. This is to allow the CSD to prepare for settlement in the cycle.

Sub-clause (ii) of 34(2)(u) deals with a very special case, namely where insolvency circumstances arise and where the CSD would want to practically pull transactions out of the cycle to minimise systemic risk. For the revocation of settlement instructions, the legislator in the definitions of the Bill (Clause 1) defines very precisely what qualifies as insolvency circumstances and when it takes effect. Also, this cannot just happen at any time, but the Act requires the CSD to prescribe in its Rules what this point in time will be when they may do so.[8]

Clause 35(2)(u) – new clause 34(2)(u) - is therefore retained.

Pledges and cessions clarity (Clause 39 of August Bill, new clause 38)

Comments: There was a concern about the terminology used and that the reference to “cession” would create confusion with the “out-and-out cession”. A commentator submitted that the words in clause 39(1) – new clause 38(1) - “[pledge or] cession to secure a debt” of the 4 August Bill should be deleted and replaced with “cession in securitatem debiti.” This is proposed to make clear that this section deals with a pledge and not an out-and-out cession as is referred to in sub-section (4), and refers back to section 38 – new clause 37 - of the Bill by virtue of the transfer of the registered ownership in relation to the out-and-out cession.

With regards to sub-clause 39(1)(d) and new clause 38(1)(d),there was a request that the Bill should clarify whether this section means that if parties *choose not* to effect the cession in securitatem debiti by means of an entry in the relevant account (given the use of the word

[8]The amended wording now correlates with the UNIDROIT principle. See Official Commentary on the Convention par 27 – 5 for a full explanation. For this to work, the depository rules must be clear on the point of revocation.

“may”), such cession is not effective *vis-a-vis* third parties (and hence only valid between the cessionary and cedent).

New clause 38(1)(a) previously incorrectly reads “*A pledge or cession to secure a debt, in respect of securities or an interest in securities held by a central securities depository, participant, authorised user or nominee, as the case may be,* ***may be effected by entry*** *in the central securities account or the securities account*…”. Respondents commented on the confusion created by the word “may” and the possible legal consequences if an entry (flag) of the pledge was not made on the respective account as required in this clause. It was requested that the wording be changed from “may” to “must”, because otherwise it would imply that this method of flagging the account would not be the only method available for creating security interests by way of pledges or cessions to secure debt.

Treasury View: On the terminology aspect, 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 Bill clearly distinguishes between “pledge or cession to secure a debt” in terms of new Clause 38(1) and “out-and-out cession” as set out in Clause 38(2).

The wording has been corrected to “must” in the revised Bill. In the case of pledges or cessions to secure a debt in terms of the new clause 38, the relevant entry in the CSD must be flagged. The intention is to provide for pledges as well as for out-and-out cessions. In the case of an out-and-out cession, an actual transfer must take place as set out in new clause 37.

MARKET ABUSE

Front running (Clause 84 of the August Bill, new clause 82)

Comments: As front-running is widely recognised as an offence in the industry it was proposed that this conduct be explicitly listed as a prohibited practice under clause 84 (of the 4 August Bill).

Treasury View: Front-running is not a form of price manipulation. Price manipulation refers to the types of contraventions that create a false price or a misleading impression of market activity. Alternatively put, insider trading, price manipulation and false statements are offences against the market as a whole. Front-running rather is an unlawful act against a specific person or persons, i.e. it is a contravention of a market participant's fiduciary duties toward his or her client. This is dealt with through the code of conduct (new clause 75) and the exchange rules. Treasury therefore disagrees that front-running be included as an offence under the new clause 82.

Deeming Provisions in terms of Prohibited Trading Practices (Clause 84 of August bill, new clause 82)

Comments: Commentators requested that certain transactions, such as when a market maker corrects or sets a reference or ruling price of an illiquid derivative, be exempt from the deeming provisions of clause 84 – "Prohibited Trading Practices." Specifically, the point was made that the deeming provisions place too great an onus on the respondent to prove that he did not execute a deeming transaction with the intent of creating a false price.

Treasury View: It is not necessary to exclude any categories of transactions from the deeming provisions as the FSB will still require proof that the market participant intended to create a deceptive appearance of the trading activity in connection with, or an artificial price for, the security relevant to that transaction.

Bringing in negligence element to insider trading

Comments: Clause 82(2) of the 4 August Bill extended the liability for insider trading and manipulative trading practices to a trader placing an order on behalf of a client, if the trader had reason to suspect that the client was an insider or was attempting to manipulate the market. This places an onus on traders to launch an investigation before each trade and to refuse trades on the basis of suspicion which may have a negative impact on client relationships if the suspicion proves to be unfounded. Manipulative trading practices may be easier to detect than determining whether a client is an insider, as the trader may not be an insider and may therefore not ordinarily know about the inside information prior to a

transaction being made public. In short it was felt that the clause is inappropriate, has unintended consequences and should be removed.

Treasury View: The Treasury agrees with this interpretation of clause 82(2) of the August 2011 Bill and therefore has removed the negligence element from the insider trading provisions. Insider trading is a criminal offence and it would be too onerous to expect traders to do a full investigation before each and every trade. The revised bill is now designed in a way that if a trader knows that a client is an insider, that trader would still contravene the Act.

Bringing in negligence element to market manipulation (Clause 84 of August bill, new clause 82)

Comments: There was concern over the test for participating in a manipulative practice being too onerous. It was proposed that the knowledge test for participating in a manipulative practice be the standard reasonable man test, as opposed to the "had reason to suspect" test. It was also suggested that perhaps the reason to suspect test be kept, but to make it a separate offence. This will be more strenuous on the dealers, but a lesser offence.

Treasury View: Criminal liability for a person who had reason to suspect that he was executing a manipulative transaction has been taken out. It is agreed that criminal liability would be too onerous and that it should remain an administrative penalty in these circumstances. However, the criminal liability remains for persons who know that they are taking part in a manipulative practice.

Bringing in negligence element to misleading, improper or false transactions (Clause 85 of August bill, new clause 83)

Comments: Commentators considered a criminal sanction for those who had reason to suspect that they were placing an order for a transaction that was misleading, improper, or false as overly harsh.

Treasury View: It is indeed inappropriate that the Bill provides that a person who placed an order whilst he had "reason to suspect" that the transaction was misleading, improper, or

false committed a criminal as well as an administrative offence. This has been changed to now be only an administrative offence. But where there is intent, in other words the person knows that the transaction was misleading, improper, or false, both criminal and administrative liability still apply.

Delete compensation obligations

Comments: It was asked that the provisions in clause 87, regarding compensation obligations, be deleted because of the difficulty in identifying people who are affected by such contraventions, the amount that such persons could claim and the amount that the offender can be held liable for.

Treasury View: The compensation orders for price manipulation and false statements have been removed. Treasury agrees that it will be almost impossible to identify persons and quantify losses suffered as a result of these actions. Compensation orders for insider trading remain, as it is possible to identify the "victims".

Publication

Comments: Respondents were concerned that the August Bill narrowed down many of the deeming provisions relating to publication and when information can be considered to be public. In particular sections 74(1)(c) and 74(2) of the SSA were taken out; it was felt that these deeming provisions were necessary and should be reinstated.

Treasury View: Treasury agrees with these comments and the deeming provisions contained in section 74(1)(c) of the SSA have been put back into the revised Bill (see clause 83).

Civil liability for insider trading

Comments: It was felt that the civil remedy of approaching a court to administer an insider trading penalty had outlived its shelf life.

Treasury View: Historically, the Directorate of Market Abuse (DMA - previously the Insider Trading Directorate) was only responsible for combating insider trading. The Enforcement Committee did not exist, and following from the King I report, the drafting committee

created the statutory civil action. It worked well and was used extensively by the DMA. The drawbacks were the high costs and the extensive time span of cases. When the Capital Markets Enforcement Committee was introduced in 2005, it became the DMA enforcement tool of choice, and the civil action has not been used since. The clauses on a civil remedy for insider trading penalties have thus been removed – these are clauses 88, “Powers of directorate in civil proceedings” as well as clause 89, “Assessment of fines and penalties” (of the August Bill).

OTHER ISSUES

Exemption for regulated persons from the Financial Advisory and Intermediary Services (FAIS) Act

Comments: Section 3(2)(b) of the SSA read together with section 45(1)(a)(i) of the FAIS Act effectively exempts persons regulated under the SSA from complying with FAIS. Removing the SSA provision in the Bill introduces uncertainty of when the FAIS Act applies and when it does not. To avoid uncertainty the Bill should expressly provide for the exemption of persons regulated under this bill from the FAIS Act.

Treasury View: A consequential amendment to Section 45(1)(a)(i) of the FAIS Act makes it clear that persons licensed and regulated under governing securities legislation are exempt from FAIS provisions. A corresponding provision in the FMB that exempts these entities from the FAIS Act would be duplication and is not as a result considered necessary. In addition, attention should be paid to the fact that only those entities regulated in terms of the Bill are exempt – entities that should be regulated but are not would not enjoy the same protection.

Limitation of liability for SROs (Clause 73 in August and revised bill)

Comment: Stakeholders argued that this clause is not clear, in the context that sometimes there is a blurring between the roles of an SRO as regulator versus its profit making operations. In other words, it is claimed that an SRO could be overly-protected by this clause as would potentially be able to claim any action or conduct as being related to its regulatory

function. An example was given where the clause renders SRO's unaccountable if they delay the implementation of a system change, a change which the SRO says is necessary in order to comply with the objects of the Act, and yet cost of delays are borne by the users of those systems rather than the SRO itself. A new clause 73(3) was proposed to specify that the protection would not apply to the SRO or its employees when acting as a service provider in terms of a contractual relationship.

Treasury View: Having tested this provision for the unintended consequence of too great protection for SROs in pursuing their regular business activities, the Treasury found that the clause is clear that this safe harbour only applies to an SRO in performance of its regulatory functions and obligations. In the example cited, such argument is upheld should the SRO be able to get some competitive advantage from the delay, which is not understood to be the case. In other words, as the SRO would gain nothing by the "delay", it is not seen to be the result of a conflict of interest. In addition, participants can also go directly to the FSB should these problems recur. Lastly, the protection does not apply to *mala fide* or grossly negligent actions.

In considering a proposed new clause 73(3), the wording of clause 73(1) would mean that SROs are only protected in the exercise of their statutory duties and functions, and that SROs are therefore not protected if they enter into commercial agreements. It would be contrary to the drafting convention in statutory law to, in one clause define the instances in which SROs enjoy a limitation of liability and, in the next sub-clause, state examples that do not fall within the protection afforded to SROs in circumstances where the very nature of the definition in any event excludes protection. This would result in an unnecessary duplication, and could lead to uncertainty if interpreted to mean that SROs will be protected in all other contractual arrangements that they may enter into, with the exclusion of agreements where SROs are service providers – which is not what is intended by section 73(1).

Clause 73 is therefore retained without amendment.

Funding arrangements (Clauses 15 and 16 of August Bill, new clauses 14 and 15)

Comments: Aligned with the Treasury policy document entitled "A safer financial sector to serve South Africa better", especially the priority of financial stability, it was submitted that the Bill should make provision for other methods of maintaining the requirements of clause 15 (of the 4 August Bill), for example the use of an organisation's balance sheet. However, the commentator noted that a provision of this nature would require the oversight of the SARB from a prudential control perspective.

It was also felt that the provision that an exchange may require its authorised users and their clients to contribute towards the funds of the exchange for the purpose of carrying on the business of the exchange (clause 16 of the 4 August Bill) would only be acceptable in the case of a mutualised exchange.

Treasury View: Clause 15 of the August Bill (new clause 14) does not prevent an exchange from using its own balance sheet to manage risk, but rather provides for alternative funding arrangements.

Clause 16 (clause 15 in the revised Bill) is a carry-over from the mutual arrangements for market infrastructure and should apply only to that form. It has been amended to reflect this.

Private Companies

Comments: Clarity was requested by the private equity industry as to whether the intention of the Bill was to regulate the securities of private companies held in certificated form. Clarity was also requested regarding whether or not the CSD and participant structure which currently exists under the SSA for listed securities will also apply to unlisted securities when the Act comes into effect. The relationship between a private equity fund and the investors into the fund is set out in detailed agreements and no active trading of the unlisted securities held by the private equity fund takes place.

Treasury View: The FMB will not regulate private companies, as these are excluded from the definition of securities. Likewise the Bill does not require that unlisted equities must be deposited into the CSD, although this may be done by choice (and noting that this principle does not apply to unlisted securities in general, as illustrated by the case of money market instruments).

General Comments Related to Unlisted Securities (Clause 77 in August and revised Bill)

Comments: Differences in business models were noted between entities that usually trade listed securities versus those, such as private equity funds, that hold unlisted securities (generally in private companies). In noting that clause 77 effectively extends the scope of the Registrar's authority to both listed and unlisted instruments, there was a related concern about undue, administratively intensive, costly compliance requirements imposed on unlisted securities.

Treasury View: It is important to distinguish between unlisted securities in a public company versus those that are in a private company. As indicated above, the securities in private companies do not fall under the Bill (as these companies are regulated in terms of the Companies Act, 2008). However for unlisted securities held in a public company, the global financial crisis has exposed shortcomings in the unregulated nature of the OTC market. The provisions of clause 77 enable and strengthen regulation of the unlisted market in line with the IOSCO and G20 recommendations.

Comments: Whilst respondents agree with the need for regulation of unlisted securities and in particular OTC trades, they were concerned about Strate having jurisdiction over the certificated environment. It was felt that Strate should only regulate securities that have been dematerialised.

Treasury View: The CSD is not responsible for balancing "certificated records" but to reconcile with the specific issuer its total issued share capital - which consists of uncertificated securities and certificated securities. It must be remembered that companies no longer have shareholder details of those shareholders holding securities in uncertificated form. For this the company relies on the CSD. Section 50(2)(a) of The Companies Act requires the company, after issuing any securities, to enter the "total number of those securities that are held in uncertificated form" in the paper register required by law and kept by issuers or their agents for certificated securities. This number of the dematerialised portion of the uncertificated securities register is referred to as the "balancing number" on the register of the issuer. In other words, to ensure proper reconciliation, the issuer relies on the CSD to ensure that there is no "over-issue" on its total issued share capital. Unlisted

securities, for example Money Market Securities, are deposited in the CSD environment in terms of the existing legislation.

Insolvency

Comments: The FMB is not considered the appropriate legislation to deal with exclusions from the provisions of the Insolvency Act, 1936. It is suggested that these amendments are rather made to the Insolvency Act as done previously in relation to section 35A and 35B of the Insolvency Act.

Treasury View: Exclusions from the Insolvency Act are dealt with through consequential amendment to Sections 35A and 35B of that Act, as suggested. However the point is noted that clause 3(3) of the Bill constitutes an override clause of all other legislation, including the Insolvency Act, should an inconsistency prevail between that legislation and the FMB. This is considered necessary given the specific nature of the financial markets regulation relative to other legislation like the Insolvency Act, and the potential severe adverse impact on financial market stability should other legislative requirements be imposed that do not fully take account of the financial systems it will effect.

Treatment of Inter-Dealer Brokers (IDBs)

Comments: IDB's are concerned that the FMB promotes the move to central order book trading of bonds, but IDB's are of the opinion that this will not grow the market. IDB's want to be consulted extensively about bond market changes as they advocate they are responsible for a lot of the liquidity in the bond market.

Treasury View: Treasury confirms its position that no substantive structural changes will be brought to the bond - or any other securities - market without considering the full impact of such changes on the financial markets, informed by the objects of the Act. However, as this discussion has no direct bearing on the structure or content of this Bill, it is deferred to the review of the bond market, taking place outside of the FMB process.

Securities lending

Comments: Clarity was requested regarding the treatment of securities lending transactions under the FMB framework, especially as regards clauses 25: Reporting of transactions in listed securities, 39: Pledge, or cession of securities to secure debt, and 40: Ranking of

interests in securities. In particular, stakeholders requested improved certainty through the regulatory formalisation of securities lending transactions.

Treasury View: Securities lending transactions play an important role in supporting capital market liquidity for the borrowers, and income generation for the lenders. However inappropriate lending and borrowing practices could undermine market stability. In recognising that these transactions remain largely outside of the regulatory net, the Treasury commits to resolving how best to formalise this sector from a regulatory perspective. At this stage it could be premature to include regulatory requirements within the securities framework, and so for now the Bill remains silent on securities lending (which is not to say that such cannot be included in future).

Definition of "trust account"

Comments: It was proposed that the regulator be required to provide guidance through subordinate regulation as to what constitutes a trust account, and when this ought to be used relative to a nominee structure.

Treasury View: Trust account is already defined in the Financial Institutions (Protection of Funds) Act and therefore it is not considered necessary to define it again in this bill. Moreover it is believed that the market understands that a trust account refers to the holding of cash whereas nominee structures refer to the holding of securities.

Auditing

Comments: There was some concern about the reference to "generally accepted accounting standards," as such standards do not exist in South Africa. The Independent Regulatory Board for Auditors (IRBA) is the national auditing standard setter and requires registered auditors to comply with the International Standards on Auditing (ISA). The Companies Act 2008 and its regulations prescribe International Financial Reporting Standards (IFRS). The wording in the Bill does not recognise these developments.

There was also concern that the 4 August Bill seemed to confuse the basis on which the audit is performed, namely the ISA, and did not recognise that the preparation of financial statements is the responsibility of the directors, and not the auditors.

Lastly, the Bill should recognise that regulated persons have to comply with the requirements of the Companies Act 2008 in the preparation of financial statements.

Treasury View: Clause 93 (clause 98 in the August Bill) has been amended in accordance with the proposals to refer to the ISA, IFRS, and the Companies Act.

Jurisdiction of FMB in relation to the Financial Intelligence Center Act, 2002 (FICA)

Comment: As both the FMB and the FICA contain overriding provisions over other legislation (see clause 3(3) in the FMB), uncertainty may result as to which Act applies in the event of an inconsistency, and may call into question the ability of the Registrar to supervise and enforce compliance with FICA, as required by that Act.

Treasury View: The FMB is not intended to override the FICA, which is legislation that specifically addresses combatting money laundering activities and the financing of terrorist and related activities. Clause 3(3) of the FMB has been amended to provide that the FMB would not override the FICA in the event of any inconsistency between a provision of the FMB and a provision of the FICA.

Clarification of Jurisdictional Issues

Comment*:* Clause 3(5) attempts to clarify jurisdictional issues, particularly but not limited to ISDA Agreements. ISDA Agreements often apply a law from another jurisdiction such as the US or EU. A possible interpretation of Clause 3(5) is that irrespective of such provisions in an ISDA Agreement the provisions of the South African FMB would also apply and in fact would take precedence. The implication of this would be that parties subject to the FMB would be obliged to clear all derivatives in South Africa and thus might not be able to trade with certain counterparties, such as the LCH for example. It was proposed that the Bill be clearer regarding different geographical jurisdictions, particularly where transactions may be subject to the laws and regulations of multiple countries. Clarity in this respect would assist in the avoidance of regulatory arbitrage and overlapping regulatory regimes. It was proposed that this complex issue be dealt with separately in the Bill rather than in Clause 3 dealing with “Application of the Act and Rules”.

Treasury View: This clause has been added to ensure that the Bill prevails in the event of any inconsistency between the provisions of the Act and the provisions of any other national legislation. With regards to OTC derivative trading these considerations will be taken into account when the subordinated legislation is drafted.

CONCLUSION

The Treasury would like to thank stakeholders for actively participating in the review process of the bill to date, and looks forward to further engagement over the parliamentary review process.

ANNEXURE A.1 - FINANCIAL MARKETS BILL MEETING LIST

MEETING SUBJECT	DATE	TIME	VENUE	REPRESENTATION
Feedback on comments	22 September 2011	15:00 to 17:00	National Treasury Offices, Pretoria	NT and FSB
SARB comments discussion	28 September 2011	14:00 to 16:00	National Treasury Offices, Pretoria	NT, FSB and Reserve Bank
Internal discussion	29 September 2011	11:00 to 17:00	FSB Offices, Pretoria	NT and FSB
Workshop arranged by FSB	30 September 2011	14:00 to 16:30	FSB Offices, Pretoria	NT and FSB
Public forum	5 October 2011	14:00 to 17:00	National Treasury Offices, Pretoria	All stakeholders
Meeting with Banking Association	18 October 2011	08:00 to 09:30	Melrose Arch	NT and Banking Association
Discussion with IDB on FMB	28 October 2011	14:00 to 15:30	FSB Offices, Pretoria	Inter-dealer brokers
Meeting on policy issues	3 November 2011	08:30 to 14:00	FSB Offices, Pretoria	NT and FSB
Meeting on remote membership and link-up in the Financial Markets Bill (foreign participation in SA markets)	9 November 2011	14:00 to 16:00	National Treasury Offices, Pretoria	NT, FSB, Strate, JSE and SARB
CSD Participant meeting on FMB	16 November 2011	08:00 to 14:00	Institute of Bankers, Parktown	NT and Institute of Bankers
FMB workshop for non-banks	17 November 2011	14:00 to 17:00	National Treasury Offices, Pretoria	NT and stakeholders
FMB discussion with FIC (teleconference between K Gibson and FIC)	22 November 2011	12:00 to 13:30	Teleconference	K Gibson and FIC
FMB workshop for non-banks	22 November 2011	14:00 to 17:00	National Treasury Offices, Pretoria	NT and stakeholders
FMB meeting with FIC	23 January 2011	11:30 to 12:30	National Treasury Offices, Pretoria	NT, FSB and FIC

ANNEXURE A.2 – RECORD OF COMMENTATORS

Company	Name
ABSA Capital	Lucien Caron (Regulatory Specialist)
ABSA Group	Anne Clayton (Head Advisory Compliance)
ASISA	Adri Messerschmidt
Banking Association	Mark Brits
Bowman Gilfillan	Anthony Colegrave
Computershare SA	Teresa van Niekerk (Executive: Regulatory Services)
Corwil Investments Holdings	Nathan Hittler (Chief Executive Officer)
Depository Trust and Clearing Corporation	Larry E Thompson (General Counsel)
Financial Intelligence Centre	Poovindree Naidoo (Legal and Policy)
Firstrand Bank	Nicki Perdikis (Regulatory Risk)
ICAP SA	Kelvin Thomson
Investec Capital Markets	Poendree Reddy (Compliance and Legal)
Investec Securities	Jacquie Howard (Legal Advisor)
JSE	Mary Nkwanyane (Secretary: Strategy and Legal Counsel)
Macquirie Securities	Lischa Gerstle (Legal Advisor)
SAVCA	J-P Fourie (Executive Officer)
Standard Bank	Wendy Dobson (Director: Regulatory Advocacy/ Group Governance)
South African Reserve Bank	Johann de Jager (General Counsel)
Strate	Maria Vermaas (Head Legal Services)