THE LEGAL FRAMEWORK PERTAINING
TO SELECTED SEGMENTS
OF THE FINANCIAL MARKET

by

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DECLARATION

DECLARATION:

In accordance with Rule G4.6.3, I hereby declare that the above-mentioned treatise/dissertation/thesis is my own work and that it has not previously been submitted for assessment to another University or for another qualification.

SIGNATURE: ____________________________________________________________
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A sound financial system is the cornerstone of any country’s economy. As South Africa has always been deemed to have a sound legal framework pertaining to the financial market, it has never faced the situation where it had to extensively review its entire legal framework. However, the recent global economic meltdown left policy makers, internationally, questioning the soundness of their financial systems and South Africa has been no exception.

This dissertation provides an overview of the legal framework pertaining to selected segments of the financial market. This legal framework is then tested against certain selected issues highlighted by the global economic meltdown in order to establish whether it was and still is sufficiently robust to effectively negotiate these challenges. In order to deal with the selected segments of the legal framework pertaining to the financial market as comprehensively as possible, the selected segments for the purposes of this dissertation include the capital market, the money market and the derivative market. This dissertation also evaluates the impact of other recent domestic developments pertaining to securities settlement in South Africa. These developments include the recently promulgated Companies Act 71 of 2008 and the currently drafted Participant Failure Manual.

This dissertation suggests that the Companies Act 71 of 2008 will have a significant impact on securities settlement. It is recommended that companies, holders of uncertificated securities and holders of beneficial interests in uncertificated securities familiarise themselves with their revised rights and obligations in order to, amongst other things, ensure compliance with this new legislative framework.

This dissertation reveals that, even though our financial system has been found to be fundamentally sound and thus far have dealt with the global economic meltdown quite well, legislative reform to conform to international best practice is imperative. It is recommended that policy makers should strive to ensure that the South African legal framework pertaining to the financial market is sufficiently aligned with the principles, methodologies and recommendations as provided for by the international institutions providing best practice. The highlighted areas of legislative reform include the legal frameworks pertaining to credit rating agencies, investor due diligence,
crisis management tools, compensation structures, accounting and valuations standards, issuer transparency, market transparency and risk management.

This dissertation highlights that a significant amount of legislative amendments and endorsements by the relevant regulators and the Master of the Court are required for the successful integration of the Participant Failure Manual into the legal framework pertaining to the financial market. If, when and how the notion of Participant Failure will be accepted and regulated by the relevant regulators, without creating a conflict of interest, remains a question to be answered.
KEY TERMS

CHAPTER ONE
INTRODUCTION

1.1 INTRODUCTION

A sound financial system is the cornerstone of any country’s economy. Inherent in a sound financial system is financial stability and the ability to overcome risks.\(^1\) Financial stability relates to stable conditions in a financial sector as a whole and is evidenced by, \textit{inter alia}, an effective regulatory infrastructure.\(^2\) The recent global economic meltdown has resulted in countries, internationally, questioning the soundness of their financial systems and accordingly, their financial stability infrastructures.

The purpose of this dissertation is to examine the South African legal framework pertaining to selected segments of the financial market in order to establish whether the legal framework in South Africa is sufficiently robust to effectively negotiate challenges posed by the current global economic meltdown. The segments selected for the purposes of this dissertation include the capital market, money market, derivative market and commodity market.\(^3\) This examination will specifically focus on the area of securities settlement in the financial market and discussions on other recent domestic developments pertaining to securities settlement in South Africa will also be included.

The following paragraphs include the meaning and role of the financial market, the problem statement, the objectives, the significance of the study, the scope of the dissertation and the research methodology.

\(^1\) These risks include, \textit{inter alia}, market risk, operational risk, credit risk, liquidity risk and financial risk.


\(^3\) For the rationale behind the selected segments see paragraph 1.6 below. The commodity market is discussed in the segment dealing with the derivative market.
Various authors define the term “financial market” in different ways. Howells and Bain\textsuperscript{4} define the financial market as an “organisational framework within which financial instruments can be bought and sold.” Fourie \textit{et al}\textsuperscript{5} define the financial market as “the mechanism that links surplus and deficit units, providing the means for the surplus units to finance deficit units either directly or indirectly through financial intermediaries.” However, for the purposes of this dissertation the most workable definition is that by Van Zyl \textit{et al}\textsuperscript{6} who define the financial market as:

“institutions, infrastructures and procedures for the direct and indirect exchange of financial assets and risk exposures by a variety of economic agents.”\textsuperscript{7}

The financial market plays an important role in the economy of a country, as well as the world as a whole.\textsuperscript{8} The role of the financial market includes:

- price setting,\textsuperscript{9}
- avoiding regulatory arbitrage;\textsuperscript{10}
- raising capital;\textsuperscript{11}
- liquidity,\textsuperscript{12}

\textsuperscript{4} Howells \& Bain \textit{Financial Markets and Institutions} 4\textsuperscript{th} ed (2004) 17.
\textsuperscript{5} Fourie, Falkena \& Kok \textit{Student Guide to the South African Financial System} 2\textsuperscript{nd} ed (1999) 11.
\textsuperscript{6} Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 8.
\textsuperscript{7} A financial asset, as referred to in the definition, can be defined as “a claim against a person or institution for the payment of a future sum of money and/or periodic payment of money.” See Fourie \textit{et al} \textit{Student Guide to the South African Financial System} 10. A financial asset is also commonly referred to as a “financial instrument” or a “financial claim.” In this dissertation the term financial instrument will be used. Economic agents denote buyers and sellers in securities transactions.
\textsuperscript{8} Kriek \& Beekman \textit{Fundamentals of Finance} 2\textsuperscript{nd} ed (2004) 18.
\textsuperscript{9} The financial market sets a price, which is also referred to as the “market price.” The market price is a price that is set by market makers who quote both buying and selling prices for financial instruments. The market, therefore, indicates the value of a financial instrument. This is also sometimes referred to as “price discovery.” See Kriek \& Beekman \textit{Fundamentals of Finance} 18 and Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 15.
\textsuperscript{10} Inefficiencies in the financial market can lead to the same securities being traded at different prices in different locations. In these circumstances, it becomes very easy for speculators to make a big risk-free profit, by buying at the lower price location and sell in the higher price location. This type of situation is known as regulatory arbitrage. See Kriek \& Beekman \textit{Fundamentals of Finance} 18.
\textsuperscript{11} The financial market provides access to capital by raising finance and making it available to borrowing entities. See Kriek \& Beekman \textit{Fundamentals of Finance} 18 and Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 14.
• investing;\textsuperscript{13} and
• payment intermediation.\textsuperscript{14}

The main function of the financial market is to provide the place where financial assets can be traded between willing buyers and sellers.\textsuperscript{15}

\textbf{1.3 PROBLEM STATEMENT}

The financial market consists of various segments, each performing a distinct and important role. The segments of the financial market include the capital market, the money market, the derivative market, the commodity market, the foreign exchange market and the insurance market. Respectively, these segments of the financial market are regulated by a wide variety of regulators and legislative measures such as legislation, regulations, rules and directives.\textsuperscript{16} In this dissertation the legislative measures pertaining to the selected segments of the financial market will be examined and evaluated to establish whether they are sufficiently robust to deal with a crisis such as the global economic meltdown.\textsuperscript{17} This examination will include an analysis of whether or not these measures are aligned to international best practice to create a uniform legal framework successfully regulating all the aspects and activities of the selected segments of the financial market. The focus will mainly fall on the area of securities settlement in the financial market and discussions on other recent domestic developments pertaining to securities settlement in South Africa will also be included.

\textsuperscript{12} Liquidity refers to “the ease with which an instrument can be readily disposed of at prevailing market prices.” See Van Zyl et al Understanding South African Financial Markets 15.
\textsuperscript{13} The financial market creates opportunities to invest money by providing resources for obtaining and selling investments in the different markets. See Kriek & Beekman Fundamentals of Finance 19.
\textsuperscript{14} The financial market provides means of effecting payment for goods and services through a number of mechanisms, for instance: electronic transfers and cheques. See Van Zyl et al Understanding South African Financial Markets 15.
\textsuperscript{15} The term “trading” refers to a match to buy and sell securities. JSE Limited “JSE Online Glossary” http://webapps.jse.co.za/glossary/browsing/search.htm?SEARCH_TERM_STARTING=T (accessed 28-10-2010). Listed securities and unlisted securities are discussed in paragraph 2 2 and derivative contracts in paragraph 2 7 2 1 below.
\textsuperscript{16} See paragraphs 2 3 and 2 4 below.
\textsuperscript{17} See paragraphs 1 5 and 4 2 below.
Any problems with the alignment of the legal framework which result in legal gaps will be highlighted and recommendations will be proposed. Accordingly, in this dissertation, the following research question will be addressed:

Is the legal framework pertaining to selected segments of the financial market sufficiently aligned and robust enough to effectively deal with challenges posed by the global economic meltdown?

1.4 OBJECTIVES

The primary objective of this dissertation is to examine and evaluate the current legal framework pertaining to selected segments of the financial market and highlight any regulatory gaps which may exist. The secondary objectives of this dissertation are to:

- gain an understanding of the legal framework and by highlighting the gaps;
- highlight any regulatory uncertainties of gaps which could inform policy makers, who would be able to take note of such gaps; and
- where necessary, amend legislation or policy documents to overcome these gaps.

1.5 SIGNIFICANCE OF THE STUDY

Internationally the world recently experienced what is referred to as “global economic meltdown.” The global economic meltdown has not only highlighted the fragilities in the global financial system, but also that significant restructuring of the legal framework pertaining to the financial market is inevitable. Against the background of the global economic meltdown, certain tried and tested legislative measures

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emanating from the current South African legal framework may not be as effective as in previous economic environment. It is, therefore, necessary to take a fresh look at the regulatory framework of certain segments of the South African financial market, evaluate the effectiveness of such framework and indicate where improvements can be made.

1 6  LIMITATIONS OF THE STUDY

As stated earlier,\(^{20}\) this dissertation will examine the legal framework pertaining to only selected segments of the financial market. Should one attempt to examine the legal framework of all the different segments of the financial market, the ambit to be covered could potentially be too broad and the dissertation may not be able to deal with all the segments comprehensively. Therefore, for purposes of this dissertation, the examination of the legal framework pertaining to the financial market will be restricted to the domestic financial market. Accordingly, the capital market, money market, derivative market and commodity market are dealt with as the selected segments of the financial market. The foreign exchange market and insurance market will be excluded from the study.

1 7  OUTLINE OF THE STUDY

*Chapter One* serves as an introduction to the dissertation as it provides an explanation of the term financial market and its role in the economy. It also provides the problem statement, the objectives, the significance of the dissertation, the scope of the proposed chapters and the research methodology.

*Chapter Two* gives an overview of selected financial market terminology, the regulators and the current legal framework pertaining to the financial market. This is followed by an examination of the segments of the financial market selected for the purposes of this dissertation and its specific legal frameworks. These segments include the capital market, money market and derivative market.

\(^{20}\) See paragraph 1 1 above.
Chapter Three provides an overview of the securities settlement process in South Africa and an examination of the impact of the new Companies Act, 2008 on securities settlement.

Chapter Four provides an overview of the global economic meltdown and examines and evaluates the impact of the global meltdown on the legal framework pertaining to the selected segments of the financial market.

Chapter Five examines the meaning of Participant Failure and provides an overview of the Participant Failure Manual, as drafted by Strate. More importantly, it also examines the impact of Participant Failure on securities settlement in South Africa.

Chapter Six consists of the summary, conclusion and recommendations of this dissertation.

18 RESEARCH METHODOLOGY

Given the purpose of this dissertation, the problem statement and objectives, a qualitative approach is appropriate. The main sources consist of existing legislation, rules and regulations as well as literature, such as textbooks and articles. Overall the desktop methodology will be utilised in this dissertation.

Chapter One contains the background, problem statement, objectives, significance and scope of the dissertation. Chapter Two contains a historical analysis of the regulators and the legal frameworks pertaining to the selected segments of the financial market. This provides a broader context within which to understand and evaluate the supervisory function and development of the legal framework pertaining to the selected segments of the financial market. Chapters Three to Five contain a critical analysis of the impact of the global economic meltdown and other recent domestic developments on the current legal framework pertaining to the selected segments. This framework is examined and its effectiveness evaluated in order to highlight any legal gaps which may exist. Where appropriate, the current legal framework is compared with the international legal framework. The international legal framework provides best practice which assists in making recommendations to the
highlighted legal gaps of the South African financial market. Chapter Six consists of the conclusion.
CHAPTER TWO
THE REGULATORY ENVIRONMENT PERTAINING TO THE FINANCIAL MARKET

2.1 INTRODUCTION

This Chapter aims to give an overview of selected terminology, the regulators and the current legal framework pertaining to the financial market. This is followed by an examination on certain segments of the financial market selected for the purposes of this dissertation and its specific legal frameworks. These segments include the capital market, money market and derivative market. The commodity market will be discussed in the segment dealing with the derivative market.

2.2 SELECTED FINANCIAL MARKET TERMINOLOGY

Given the overall content of this dissertation certain terminology pertaining to the financial market requires clarification. These terms are explained with reference to the diagram below. The following diagram illustrates an overview of the role-players and financial instruments pertaining to the financial market.
As noted above, the main function of the financial market is to provide the place where “securities” can be traded between willing buyers and sellers. Section 1 of the Securities Services Act defines securities as:

“shares, stocks and depository receipts in public companies and other equivalent equities, other than shares in a share block company as defined in the Share Blocks Control Act 59 of 1980; notes; derivative instruments; bonds; debentures; anticipatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act 45 of 2002 and units or any other form of participation in a foreign collective investment scheme approved by the registrar of Collective Investment Schemes; units or any other form of participation in a collective investment scheme licensed or registered in a foreign country; instruments based on an index; the securities contemplated that are listed on an external exchange; and an instrument declared by the Registrar by notice in the Gazette to be a security for the purposes of the Companies Act and rights in the securities. The terms securities exclude money market instruments except for the purposes of Chapter IV of the SSA and any security specified by the registrar by notice in the Gazette.”

A security enters the financial market by means of issuance in the primary market, after which they become tradable in the secondary market. The issuance of a

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21 See paragraph 1 2 above.
22 Securities Services Act 36 of 2004 (hereinafter “the SSA”).
23 For a further discussion on the primary and secondary market see paragraph 2 5 1 below. Also see Van Zyl et al Understanding South African Financial Markets 326.
security is conducted by an issuer. An issuer refers to “an issuer of securities and, in Chapter IV of the SSA, includes an issuer of money market instrument.”

There are two ways in which the rights pertaining to securities may be symbolised. It can either be in certificated form (paper) or in uncertificated form. Certificated securities are “securities evidenced by a certificate or written instrument.” Unlike certificated securities, uncertificated securities are “securities that are not evidenced by a certificate or written instrument and are transferable by entry without a written instrument.”

Uncertificated securities are held and administered by a central securities depository, which refers to a person who is licensed as a CSD in accordance with the SSA. In the CSD environment, one finds what is referred to as a “Participant”. A “Participant” is “a person that holds in custody and administers securities or an interest in securities and that has been accepted in terms of section 34 by a central securities depository as a participant in that central securities depository.” Such a Participant is commonly referred to as a Central Securities Depository Participant. The terms “Participant” and “CSDP” are used interchangeably and except for Chapter 5 of this dissertation, the term “CSD Participant” will be used.

Securities can either be unlisted securities or listed securities. Unlisted securities are securities not listed on an exchange and are traded over-the-counter. Listed securities are securities included in the list of securities kept by an exchange in accordance with the SSA. In other words, listed securities are issued and traded on an exchange. An exchange is “a person who constitutes, maintains and provides an infrastructure:

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24 S 1 of the SSA.
25 Ibid.
26 Ibid.
27 Central Securities Depository (hereinafter a “CSD”).
28 In terms of s 32 of the SSA.
29 S 1 of the SSA.
30 Central Securities Depository Participant (hereinafter a “CSD Participant”) Over-the-counter (hereinafter “OTC”). For a further discussion on the OTC market see paragraph 2 5 1 below.
31 S12 of the SSA sets out the Listing Requirements with which an exchange must comply. Also see s 1 of the SSA.
a) for bringing together buyers and sellers of securities;
b) for matching the orders for securities of multiple buyers and sellers; and
c) whereby a matched order for securities constitutes a transaction.”

An exchange may appoint what is referred to as an “authorised user”. An authorised user is a person “authorised by an exchange in terms of the exchange rules to perform such securities services as the exchange rules may permit” and is commonly referred to as a “broker”. The securities services performed by an authorised user refers to services provided in terms of the SSA in respect of “the buying and selling of securities; the custody and administration of securities; the management of securities by an authorised user; the clearing of transactions in listed securities; and the settlement of transactions in listed securities.”

In the financial market, reference is also made to the term “regulated person”. A “regulated person” refers to “self-regulatory organisation or any other person who provides or who previously provided securities services.” A “self-regulatory organisation” is described as “an exchange or a central securities depository.” Lastly, a client refers to “any person who uses the services of an authorised user or a Participant, as the case may be.” The client is commonly the buyer or the seller of securities.

2.3 THE REGULATORS IN THE FINANCIAL MARKET

2.3.1 Introduction

In every financial market system there is a need for regulators. Regulators supervise and regulate different aspects and activities within the financial market. South Africa does not have a single regulator, as different sections of the South African financial

33 S 1 of the SSA.
34 Ibid.
35 A “broker” can be defined as a “trading party, who trades in the security market either for itself or for its clients.” Strate Limited “Glossary” http://www.strate.co.za/glossary.aspx (accessed 10-10-2010).
36 Ibid.
37 Ibid.
38 Self-regulatory organisation (hereinafter “SRO”).
39 Ibid. For the current SRO’s operating in terms for the SSA see paragraph 2.3.1 below.
40 Ibid.
market are regulated by different regulators. For example, banks are regulated by the Banking Supervision Department\(^4\) of the South African Reserve Bank\(^5\) whereas non-banking institutions are regulated by the Financial Services Board.\(^6\) Until recently, two licensed exchanges, namely the JSE Limited\(^7\) and the Bond Exchange of South Africa,\(^8\) operated as separate SRO’s in terms of the SSA. However, in 2009, these two exchanges consolidated and now operate as a single exchange and accordingly, as a single SRO.\(^9\) The CSD, Share Transactions Totally Electronic Limited,\(^10\) also operates as a SRO in terms of the SSA. These SRO’s perform their duties in terms of the SSA.\(^11\)

The South African financial market consists of the following regulators: the SARB, the FSB, Strate and the JSE. The following paragraphs provide an overview of these respective regulators and also include discussions on their establishment and organisational structures.

### 2.3.2 The South African Reserve Bank

#### 2.3.2.1 History of the SARB

The SARB is the central bank of South Africa.\(^12\) The need for the SARB dates back to before and immediately after the First World War (1914 to 1918).\(^13\) During this

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\(^{4}\) Banking Supervision Department (hereinafter the “BSD”). For a discussion on the BSD see paragraph 2.3.2.3 below.

\(^{5}\) South African Reserve Bank (hereinafter the “SARB”). For a discussion on SARB see paragraph 2.3.2 below.

\(^{6}\) Financial Services Board (hereinafter the “FSB”). For a discussion on the FSB see paragraph below 2.3.3 below.


\(^{8}\) Bond Exchange of South Africa (hereinafter “BESA”). For a discussion on BESA see paragraph 2.3.5.3 below.

\(^{9}\) The consolidation of the JSE and BESA is discussed in greater detail in paragraph 2.3.5.4 below.

\(^{10}\) Share Transactions Totally Electronic Limited (hereinafter “Strate”). For a discussion on Strate see paragraph 2.3.4 below.

\(^{11}\) Van Zyl et al Understanding South African Financial Markets 127.


time, all commercial banks undertook much the same functions and one of these functions included the issuing of banknotes to the public.\textsuperscript{51} At this point, no legislation regulating such issuance was in place and all the banks were simply obliged to convert notes held by the public into gold when tendered at their branches.\textsuperscript{52}

After the First World War, the United Kingdom’s gold price ascended above that of South Africa. As a result, a profit could be made by simply converting banknotes into gold in South Africa and in turn, selling this same gold in London. This caused the South African commercial banks to trade at a huge loss. In 1919, the commercial banks appealed to the government to release them from their obligation to convert their banknotes into gold on demand. In that same year, the Gold Conference of October 1919 was held.\textsuperscript{53} The Conference recommended, \textit{inter alia}, a uniform banking act to replace the separate banking laws of the four provinces in force at that time, as well as the establishment of a single and non-commercial institution to assume responsibility for the issuing of banknotes and for taking over the gold held by commercial banks.\textsuperscript{54} Parliament accepted this recommendation and in December 1920, the Currency and Bank Act\textsuperscript{55} was promulgated. This Act specifically provided for the establishment of a central bank, the SARB, and it opened its doors for business for the first time on 30 June 1921.\textsuperscript{56} The Currency and Banking Act was amended from time to time and re-enacted in the form of the South African Reserve Bank Act of 1944.\textsuperscript{57} This 1944 Act was repealed and substituted by the South African Reserve Bank Act of 1989.\textsuperscript{58}

\begin{itemize}
\item \textsuperscript{51} South African Reserve Bank “Factors leading to the founding of the South African Reserve Bank” http://www.icbs.co.za/internet/Publication.nsf/LADV/7EE59A82CC1F1E374225737004640FF/$File/Fact+Sheet+6.pdf (accessed 23-10-2010).
\item \textsuperscript{52} South African Reserve Bank “About us – Background and Structure - Establishment of the South African Reserve Bank” http://www.reservebank.co.za/ (accessed 23-10-2010).
\item \textsuperscript{53} Ibid.
\item \textsuperscript{54} South African Reserve Bank “Factors leading to the founding of the South African Reserve Bank” http://www.icbs.co.za/internet/Publication.nsf/LADV/7EE59A82CC1F1E374225737004640FF/$File/Fact+Sheet+6.pdf (accessed 23-10-2010).
\item \textsuperscript{55} Act 31 of 1920.
\item \textsuperscript{56} South African Development Community Bankers “South African Reserve Bank” http://www.sadcbankers.org/SADC/SADC.nsf/LADV/B3796F16F143B8364225726E00494933/$File/South+Africa.pdf (accessed 19-10-2010).
\item \textsuperscript{57} Act 29 of 1994.
\item \textsuperscript{58} Act 90 of 1989 (hereinafter “the SARB Act”). Recently, in September, 2010, the President signed into law the South African Reserve Bank Amendment 4 of 2010 (“the SARB Amendment Act”).
\end{itemize}
Sections 223 to 225 of the Constitution, the SARB Act and the SARB regulations present the structure of the business of the SARB and describe the functions and also the actions that the SARB may take in fulfilling its purpose. Section 223 of the Constitution provides for the establishment of the SARB as the central bank of South Africa. Section 224(1) of the Constitution and section 3 of the SARB Act provide that the primary objective of the SARB is to protect the value of currency of the Republic in the interest of balanced and sustainable economic growth in the Republic. Section 224(2) states that “[t]he South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters.” Section 225 states that the powers and functions of the SARB are those customarily exercised and performed by central banks, which powers and functions must be determined by an Act of Parliament (the Act referred to is the SARB Act) and must be exercised or performed subject to the conditions prescribed in terms of that Act.

2322 The Role of the SARB

The SARB plays multiple roles in the financial market and include the following. Firstly, the SARB, as lead regulator of banks in South Africa, is responsible for bank regulation and supervision. It performs this function by issuing banking licences to banking institutions and also by monitoring their activities. Secondly, Section

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60 In conjunction with the SARB Amendment Act, revised and additional SARB regulations were published by the National Treasury. In September 2010, these Regulations came into effect shortly after the SARB Amendment Act was signed. These Regulations focus on, inter alia, rectification, transfer of shares and shares certificates and limitation on liability in terms if the transfer of shares.
62 S 3 of the SARB Act and s 224 (1) of the Constitution.
63 In terms of the Banks Act 94 of 1990 (hereinafter “the Banks Act”) as well as the Mutual Banks Act 124 of 1993 (hereinafter “the Mutual Banks Act”). See South African Reserve Bank “SARB activities - Bank Supervision” http://www.reservebank.co.za/ (accessed 23-10-2010). Also see
10(c)(i) of the SARB Act states that the SARB may “perform such functions, implement such rules and procedures and, in general, take such steps as may be necessary to establish, conduct, monitor, regulate and supervise payment, clearing or settlement systems.” The National Payment System Act\(^{64}\) enables the SARB to perform these functions as contemplated and the authority to perform these functions vests in the National Payment System Department\(^{65}\) of the SARB.\(^{66}\)

Finally, according to section 10 of the SARB Act,\(^{67}\) the SARB may also exercise the following powers relating to the financial market:

- “(g) buy, sell, discount or re-discount bills of exchange drawn or promissory notes issued for commercial, industrial or agricultural purposes, or exchequer bills of the Government of the Republic or of the government of any other country, or securities of a local authority in the Republic;

- (h) buy, sell or deal in financial instruments and, in accordance with the provisions of any law regulating the safe deposit of securities, hold such financial instruments in safe custody, or cause such financial instruments to be held in safe custody, for other persons;

- (i) issue its own interest-bearing securities for purposes of monetary policy and buy, sell, discount or re-discount, or grant loans or advances against, such securities;

\(^{64}\) Act 78 of 1998 (hereinafter the “NPS Act”).

\(^{65}\) National Payment System Department (hereinafter the “NPS Department”).


\(^{67}\) S 10(g) – (m) of the SARB Act.
subject to the provisions of section 13(a) and (b), enter into repurchase agreements with any institution in respect of interest-bearing securities or such other securities as the Bank may determine;

(k) buy, sell, or deal in precious metals and hold in safe custody for other persons gold, securities or other articles of value;

(l) buy and sell foreign currencies and

(m) buy, sell, accept or deal in special drawing rights.”

The SARB does not only fulfil various roles in the financial market, but also in the economy of South Africa as a whole. These roles include:

• the issuance of bank notes and coins;

• it acts as the banker to the government, the custodian of the country’s official gold and other foreign reserves and the government’s funding agent;

• it also formulates and implements monetary and exchange rate policy in cooperation with the National Treasury;

• it monitors and promotes the stability of the financial system;

• it administers exchange control;

• it compiles and publishes macroeconomic data; and

• it acts as lender of last resort.


S 10 (1) (a) and (b) of the SARB Act.

This role is not provided for in the SARB Act as such, but is communicated by the SARB as part of its functions.

By acting as the lender of last resort the SARB provides, inter alia, liquidity assistance to banks experiencing liquidity problems. This function has been performed by the SARB basically from its establishment. South African Reserve Bank “Introduction to the South African Reserve Bank” http://www.reservebank.co.za/internet/Publication.nsf/LADV/EE3B80583309400E42257337004404A0/$File/Fact+sheet+1.pdf (accessed 25-10-2010); South African Reserve Bank “Factors leading to the founding of the South African Reserve Bank”
2323 The Organisational Structure of the SARB

The SARB is divided into various departments, each with its own designated duties and functions to ensure effective supervision and regulation.\textsuperscript{72} For purposes of this dissertation, the BSD, the Financial Markets Department\textsuperscript{73} and the NPSD are of importance.

The BSD is responsible for bank regulation and supervision and strives to achieve a sound and efficient banking system in the interest of the whole of the economy.\textsuperscript{74}

The FMD of the SARB, \textit{inter alia}, implements the Reserve Bank's interest rate policy,\textsuperscript{75} facilitates the effective functioning of the domestic financial markets and manages the SARB's gold and foreign exchange reserves.\textsuperscript{76}

The NPSD of the SARB oversees National Payment System\textsuperscript{77} and strives to reduce systemic risk.\textsuperscript{78} The SARB describes the function of the NPS as follow:\textsuperscript{79}

"The National Payment System (NPS) does not only entail payments made between banks, but encompasses the total payment process. This includes all the systems, mechanisms, institutions, agreements, procedures, rules and laws that come into play from the moment an end-user, using a payment instrument, issues an instruction to pay another person or a business, through to the final interbank settlement of the transaction in the books of the central bank. The NPS...

\textsuperscript{72} See Annexure C for a diagram on the Organisational Structure of the SARB.
\textsuperscript{73} Financial Markets Department (hereinafter “the FMD”).
\textsuperscript{74} South African Reserve Bank “SARB activities - Bank Supervision” http://www.reservebank.co.za/ (accessed 23-10-2010).
\textsuperscript{75} For a discussion on this role of the SARB see paragraph 2 6 2 5 below.
\textsuperscript{77} National Payment System (hereinafter “the NPS”).
\textsuperscript{78} South African Reserve Bank “SARB activities - Payment & Settlement Systems” http://www.reservebank.co.za/ (accessed 23-10-2010). In terms of s1 of the SSA systemic risk means “the danger of a failure or disruption of the Republic's financial system as a whole.”
therefore enables transacting parties to exchange value to conduct business efficiently.”

The NPS of the SARB provides an inter-bank settlement service via the real-time electronic settlement system, the South African Multiple Option Settlement\textsuperscript{80} (SAMOS) system.\textsuperscript{81}

\section*{2.3.3 The Financial Services Board}

\subsection*{2.3.3.1 The Establishment of the FSB}

The FSB was established in terms of the Financial Services Board Act\textsuperscript{82} and on 1 April 1991, became operational.\textsuperscript{83} As noted above,\textsuperscript{84} the FSB oversees the South African non-banking institutions. As part of its functions it sets the regulatory framework as well as the minimum standards and practices for market participants.\textsuperscript{85} According to the FSB Act the functions of the FSB are:\textsuperscript{86}

\begin{quote}
\textit{to supervise compliance with laws regulating financial institutions\textsuperscript{87} and the provision of financial services;}
\end{quote}

\textsuperscript{80} South African Multiple Option Settlement (hereinafter “SAMOS”).
\textsuperscript{82} Act No 97 of 1990 (hereinafter “the FSB Act”).
\textsuperscript{83} Van Zyl et al Understanding South African Financial Markets 128.
\textsuperscript{84} See paragraph 2.3.1 above.
\textsuperscript{85} Financial Services Board “Welcome to the FSB” http://www.fsb.co.za/ (accessed 11-10-2010).
\textsuperscript{86} S 3 of the FSB Act.
\textsuperscript{87} S 1 of the FSB Act defines a “financial institution” as (a) any pension fund organisation registered in terms of the Pension Funds Act, 1956 (Act No. 24 of 1956), or any person referred to in section 13B of that Act administering the investments of such a pension fund or the disposition of benefits provided for in the rules of such a pension fund; (b) any friendly society registered in terms of the Friendly Societies Act, 1956 (Act No. 25 of 1956), or any person in charge of the management of the affairs of such a society; (c) a collective investment scheme as defined in section 1 of the Collective Investment Schemes Control Act, 2002. a manager, trustee, custodian or nominee company registered or approved in terms of that Act, and an authorised agent of such a manager; [Subpara. (iii) substituted by s. 117 of Act 45/2002 and s. 19 of Act 22/2008] (iv) ...
* to advise the Minister on matters concerning financial institutions and financial services, either of its own accord or at the request of the Minister; and

* to promote programmes and initiatives by financial institutions and bodies representing the financial services industry to inform and educate users and potential users of financial products and services."

The FSB supervises the non-banking financial institutions through the respective Acts enacted for this purpose. The Acts administered by the FSB include:

- FSB Act;
- the SSA;

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2 3 3 2 The Organisational Structure of the FSB

The FSB consists of various divisions and departments, designed to regulate, supervise and perform such functions as assigned to it. These divisions and departments operate in terms of the above-mentioned Acts and consist of the following:

- Financial Advisory and Intermediary Services Division;
- Capital Market Department; Inspectorate Department;
- Insurance Department; the Collective Investment Schemes Department;
- Retirement Funds and Friendly Societies Department; and
- The Directorate of Market Abuse.

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89 Act 45 of 2002.
90 Act 37 of 2002 (hereinafter “the FAIS Act”).
92 Act 8 of 1993.
93 Act 80 of 1998.
95 Act 52 of 1998.
96 Act 24 of 1956.
98 Act 32 of 1996.
99 See Annexure D for a diagram on the Organisational Structure of the FSB.
100 See paragraph 2 3 3 1 above.
For the purposes of this dissertation the Financial Advisory and Intermediary Services Division\textsuperscript{101} and the Capital Markets Department\textsuperscript{102} are of importance.

The FAIS Division is responsible for the regulation and supervision of Financial Service Providers and is regulated by the FAIS Act.\textsuperscript{103} The FAIS Act defines a “financial service provider” as:

\begin{quote}
“any person,\textsuperscript{104} other than a representative,\textsuperscript{105} who as a regular feature of the business of such person –
\begin{itemize}
  \item[a)] furnishes advice,\textsuperscript{106} or
  \item[b)] furnishes advice and renders any intermediary service,\textsuperscript{107} or
\end{itemize}
\end{quote}

\textsuperscript{101} Financial Advisory and Intermediary Services Division (hereinafter “the FAIS Division”).
\textsuperscript{102} Capital Markets Department (hereinafter “the CMD”).
\textsuperscript{103} Financial Services Board “FAIS - About the Financial Advisory and Intermediaries Services Division” http://www.fsb.co.za/ (accessed 11-10-2010).
\textsuperscript{104} In terms of s 1 of the FAIS Act the term “person” refers to “any natural person, partnership or trust, and includes-
\begin{itemize}
  \item[a)] any organ of state as defined in section 239 of the Constitution of the Republic of South Africa, 1996
  \item[b)] any company incorporated or registered as such under any law
  \item[c)] any body of persons corporate or incorporate.”
\end{itemize}
\textsuperscript{105} In terms of s 1 of the FAIS Act the term “representative” is defined as “any person employed or mandated by such first-mentioned person, who renders a financial service to a client for or on behalf of financial service provider, on terms of conditions of employment or any other mandate, but excludes a person rendering clerical technical, administrative, legal, accounting or other service in a subsidiary or subordinate capacity, which service-
\begin{itemize}
  \item[a)] does not require judgment on the part of the latter person; or
  \item[b)] does not lead a client or any specific transaction on respect of a financial product in response to general enquiries.”
\end{itemize}
\textsuperscript{106} In terms of s 1 of the FAIS Act the term “advice” means “subject to subsection (3)(a), any recommendation, guidance or proposal of a financial nature furnished, by any means or medium, to any client or group of clients –
\begin{itemize}
  \item[a)] in respect of the purchase of any financial product; or
  \item[b)] in respect of the investment in any financial product; or
  \item[c)] on the conclusion of any other transaction, including a loan or cession, aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product; or
  \item[d)] on the variation of any term or condition applying to a financial product, on the replacement of any such a product, or on the termination of any purchase of or investment in ant such product, and irrespective of whether or not such advice –
  \begin{itemize}
    \item[i)] is furnished in the course of or incidental to financial planning in connection with the affairs of the client; or
    \item[ii)] results in any purchase, investment, transaction, variation, replacement or termination, as the case may be being effected.”
\end{itemize}
\textsuperscript{107} In terms of s 1 of the FAIS Act an “intermediary service” means “subject to subsection (3)(b), any act other that the furnishing of advice, performed by a person for or on behalf of a client or product supplier-
\begin{itemize}
  \item[a)] the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier; or
  \item[b)] with a view to –
c) renders an intermediary service." (my underlining)

The FAIS Division is subdivided into four departments, namely the Registration Department, the Supervision Department, Compliance Department and the Enforcement Department. The CMD regulates the capital markets in terms of the SSA. It was the CMA, together with a drafting team consisting of industry representatives and experts, who designed the SSA in conjunction with the National Treasury. The mission of the CMD is “to ensure sound, efficient and fair capital markets and related services for the trade of securities, including appropriate mechanisms for investor protection.” The CMD also ensures compliance with international regulatory standards by participating in the International Organisation of Securities Commissions. IOSCO has, inter alia, laid down 38 IOSCO Objectives and Principles of Securities

i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier of in which the client gas invested;

ii) collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of a financial product; or

iii) receiving, submitting or processing the claims of a client against a product supplier.”

S 1 of the FAIS Act.

The Registration Department is responsible for, amongst others, the processing of licence applications, approval of compliance officers, profile changes and the collection of levies. The Supervision Department is responsible for, amongst others, the supervision of authorised Financial Services Providers by way of on-site visits, the analysis of financial statements and the compliance of reports. The Compliance Department, amongst others, investigates complaints against FSP’s and is responsible for taking regulatory action against authorised providers in the form of suspension or withdrawal of licenses. The Enforcement Department oversees and regulates the interaction between the FAIS Division and the Enforcement Committee. See Financial Services Board “FAIS - About the Financial Advisory and Intermediaries Services Division” http://www.fsb.co.za/ (accessed 11-10-2010) and Financial Services Board “Service level commitment by the Registrar of financial services providers” ftp://ftp.fsb.co.za/public/FAIS_SLC_2008-12-04.pdf (accessed 11-10-2010).

Van Zyl et al Understanding South African Financial Markets 130. Ibid.


International Organisation of Securities Commissions (hereinafter “IOSCO”). For a further discussion on IOSCO see paragraph 2 4 8 1 below. Also see International Organisation of Securities Commission at http://www.iosco.org/ (accessed 12-10-2010).
South Africa, through the CMD, intends to comply with these objectives and principles.\(^\text{115}\)

Operating in the CMD is the Financial Markets Advisory Board,\(^\text{116}\) which was established in terms of the Financial Markets Control Act.\(^\text{117}\) The purpose of the FMAB is to, on its own initiative and at the request of the Minister or the registrar, investigate and report or advise on, administrative and technical matters concerning regulated persons or the provision of securities services.\(^\text{118}\)

### 2.3.4 Central Securities Depository

In 1995, the introduction of the Johannesburg Equities Trading\(^\text{119}\) highlighted insufficiencies in the JSE’s paper-based settlement system. As a result of the JET system, shares were no longer traded on a trading floor and the number of daily trades increased tremendously. The incapability to handle these increases efficiently led to the realisation that a transition into an effective electronic settlement system was needed.\(^\text{120}\)

Consequently, a CSD known as Shares Transactions Totally Electronic (STRATE) was established by the JSE, in collaboration with South Africa’s four largest


\(^{115}\) Van Zyl et al *Understanding South African Financial Markets* 131. It should be noted that before June 2010, only 30 objectives and Principles were laid down. However, the global economic meltdown and subsequent changes in the regulatory environment necessitated a revision of these objectives and principles. Eight additional principles were added. The principles relevant for the purposes of this dissertation will be discussed in Chapter 4 below. IOSCO “Global securities regulators adopt new principles and increase focus on systemic risk” [http://www.iosco.org/news/pdf/IOSCONEWS188.pdf](http://www.iosco.org/news/pdf/IOSCONEWS188.pdf) (accessed 03-12-2010). Also see International Organisation of Securities Commissions *Objectives and Principles of Securities Regulation* June 2010.

\(^{116}\) Financial Markets Advisory Board (hereinafter the “FMAB”).

\(^{117}\) Act 55 of 1989 (hereinafter “the FMCA”).

\(^{118}\) S 6(7) of the SSA. It has to be noted how broad the ambit of the FMAB is, as securities are very broad as defined in the SSA. See the definition of securities in paragraph 2.2 above.

\(^{119}\) Johannesburg Equities Trading (hereinafter “JET”). JET was the automated trading system of the JSE at the time. This system was subsequently replaced by the London Exchange’s SETS System in 2002 and again by TradElect in 2007. See paragraph 2.3.5.2 below.

\(^{120}\) Strate Limited “History of Strate” [http://www.strate.co.za/aboutstrate/overview/history%20of%20strate.aspx](http://www.strate.co.za/aboutstrate/overview/history%20of%20strate.aspx) (accessed 10-10-2010).
commercial banks, in 1999. In August 2003, STRATE Limited was formed by the merger of STRATE, the clearing and settlement house of BESA, UNEXcor, and the Central Depository Limited. STRATE Limited was rebranded in 2007 as Strate Limited. This dissertation uses the rebranded name.

Strate handles the settlement of equities, warrants and bonds for the JSE and recently added the electronic settlement of money market securities to its portfolio of services. The main purpose of Strate is to mitigate risk, bring efficiencies to the market and improve the profile of South Africa as an investment destination.

Strate is regulated by the SSA and in accordance with the SSA, issues its own CSD Rules and Directives.

In terms of the SSA, a CSD must “have made arrangements for the proper supervision of compliance by Participants with the depository rules.” Consequently, the controlling body of Strate has delegated its supervisory obligations to the Strate Regulatory and Supervisory Committee. This committee assists the controlling body in discharging its regulatory and supervisory obligations in terms of the SSA and the CSD Rules.

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123 This dissertation uses the rebranded name.
124 The term “settlement” and the settlement process in South Africa are discussed in paragraphs 3 1 and 3 2 below.
126 Rules of Strate Limited August 2010 (as amended). Hereinafter “the CSD Rules.” Strate also publishes Practice Notes. However, these Practices Notes are not referred to or required by the SSA and are merely utilised for interpretative purposes. For a discussion on the CSD Rules and Directives see paragraph 2 5 2 3 below.
127 S 31(1)(b) of the SSA.
128 The controlling body of Strate consists of the board of directors of Strate.
2 3 5  JSE Limited

2 3 5 1  Introduction

During 2009, BESA became a wholly owned subsidiary of the JSE.\textsuperscript{130} Accordingly, the JSE is now the single exchange in South Africa. However, a discussion on the establishment and the development of both the JSE and BESA is still necessary as it provides a background to the corporate identity of the JSE.

2 3 5 2  JSE Limited

The JSE was established in 1887, following the discovery of gold on the Witwatersrand in 1886.\textsuperscript{131} In 1963, it joined the World Federation of Exchange.\textsuperscript{132}

The JSE was deregulated through the introduction of limited liability corporate and foreign membership in 1995 and the JSE’s open outcry trading floor was closed. It was replaced by an automated trading system, known as the JET system,\textsuperscript{133} in 1996.

The JSE introduced the Securities Exchange News Service,\textsuperscript{134} to provide for the early and wide dissemination of all information that may have an effect on the prices of securities that trade on the JSE, in 1997.\textsuperscript{135}

The JSE pledged a leading role in the establishment of Strate in 1999\textsuperscript{136} and all the JSE listed securities were successfully dematerialised\textsuperscript{137} and migrated to Strate in 2002. The JSE acquired the South African Futures Exchange\textsuperscript{138} in 2001 and

\begin{footnotesize}
\begin{enumerate}
\item This consolidation is discussed in greater detail in paragraph 2 3 5 4 below.
\item See footnote 119 above.
\item Securities Exchange News Service (hereinafter “SENS”).
\item As noted in paragraph 2 3 4 above.
\item Dematerialisation means the “elimination of physical certificates or documents of title which represent the ownership of Securities so that the Securities exist only as electronic records.” See Strate Limited “Glossary” “Glossary” http://www.strate.co.za/glossary.aspx (accessed 10-10-2010).
\item South African Futures Exchange (hereinafter “SAFEX”).
\end{enumerate}
\end{footnotesize}
consequently became the leader in both equities and equity and agricultural derivatives trading in South African.\textsuperscript{139}

The JSE JET system was replaced by the London Stock Exchange’s SETS system, hosted and operated from the London Stock Exchange in London, in 2002. This system was called “JSE SETS.” Following this system, the JSE introduced another system, called, InfoWiz, in that same year. The purpose of InfoWiz is to provide a world-class information dissemination system and substantially improve the distribution of real-time equities market information. During this year, the JSE also launched a free float indexing system in conjunction with FTSE, namely the FTSE/JSE African Index Series to replace the then existing indices.\textsuperscript{140}

The JSE launched Alternative Exchange (AltX), which focuses on good quality small and medium-sized high growth companies, in 2003 and the Socially Responsible Investment (SRI) Index, which measures compliance by companies with triple bottom line criteria around economic, environmental and social sustainability, in 2004. The JSE launched Yield-X\textsuperscript{141} in 2005, followed by the commencement of over-the-counter trading in JSE shares with settlement of the trades occurring through Strate in the same year. The JSE demutualised and was incorporated in South Africa as JSE Limited, a public unlisted company, in 2005 and listed on the JSE Main Board in 2006.\textsuperscript{142} The JSE SETS system was subsequently replaced by the TradElect system in 2007.\textsuperscript{143}

It is evident from the above that, for the past almost 120 years, the JSE evolved from a traditional trading floor based equities trading market to a modern securities exchange providing fully electronic trading, clearing and settlement in equities,

\textsuperscript{140} Ibid.
\textsuperscript{141} See paragraph 2724 below.
financial and agricultural derivatives and other associated instruments. The main function of the JSE is to facilitate the raising of capital by borrowers in the primary market and trading of securities in the secondary market by lenders and investors. The JSE is regulated by the SSA and in accordance with the SSA issues its own Rules, Directives and Guarantee Fund Rules.

2353 Bonds Exchange of South Africa

The establishment of BESA dates back to the 1980’s when the “Stals/Jacobs Report” recommended tight control via regulation in the financial market under the umbrella of the then FMCA. The authorities, however, were of the opinion that self-regulation by market participants were more acceptable and desirable than imposed regulation. In light of this view, the majority of the bond market participants formed a voluntary association, the Bond Market Association, in 1989. In 1996, this Bond Market Association was formally licensed as an exchange, BESA, in terms of the SSA. BESA is responsible for operating and regulating the debt securities and interest-rate derivatives markets in South Africa.

BESA established a Bond Traders’ Association to represent and promote the interests of the BTA members in their relations with the bond market’s regulatory authority, BESA, and to promote good relations between its members in 2002. BESA also formed a Derivatives Traders’ Association to represent the views and interests of the user firms registered to trade BESA-listed derivative instruments in

147 Strate Limited Bonds Handbook 46.
150 Bond Traders’ Association (hereinafter “the BTA”).
152 Derivatives Traders’ Association (hereinafter “the DTA”).
As the direct regulator of the bond market, BESA operates within the framework of the SSA and a set of rules and directives approved by the FSB.

### 2.3.5.4 The Consolidation of the JSE Limited and Bond Exchange of South Africa

The JSE announced that it had made a conditional offer to acquire the entire ordinary share capital of BESA on 27 October 2008. The deputy CEO of the JSE, Nicky Newton-King, stated that the proposed deal was “intended to create a world-class, unified multi-product exchange that efficiently provides sophisticated trading, clearing and settlement infrastructure to all its clients.”

The requisite majority of BESA Shareholders approved the proposed consolidation on 6 February 2009. This was followed by the unconditional approval from the Competition Tribunal on the 3 June 2009. The High Court of South Africa sanctioned the consolidation on the 9 June 2009 and BESA became a wholly owned subsidiary of the JSE on 22 June 2009. According to the JSE, “the consolidation will also help promote South Africa’s international competitiveness by leveraging the best each exchange has to offer to deepen the market, improve liquidity, create economies of scale and ultimately bring user costs down.”

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156 JSE Limited “Joint Announcement by BESA and the JSE relating to the Approval of Scheme of Arrangement by Competition Authorities” http://www.jse.co.za/Libraries/Interest_Rate_Market_BESA_Aquisition_Documents/Announcement_after_tribunal_approval_final_3_June_2009.sflb.ashx (accessed 10-10-2010).
157 JSE Limited “Joint announcement by BESA and the JSE relating to the sanctioning of the scheme of arrangement and the scheme of arrangement becoming unconditional” http://www.jse.co.za/Libraries/Interest_Rate_Market_BESA_Aquisition_Documents/Announcement_of_sanction_and_finalisation_date.sflb.ashx (accessed 24-10-2010).
Since the JSE and BESA are now operating as a single exchange, namely, the JSE, the legal framework pertaining to the JSE and BESA will have to be re-evaluated to determine whether both exchanges' regulatory frameworks should continue to exist in its current form or whether amendments will have to be made to consolidate some of these regulatory measures in order for the JSE to operate effectively and successfully. Until such time, Newton-King stated that "[l]isting requirements, membership requirements and trading, clearing, and settlement rules will remain unchanged."\textsuperscript{159} To date, nothing has been published in this regard.

The JSE recently published its first data after the consolidation. For the year ended 31 March 2010, 405 companies were listed on the JSE. Its share turnover amounted to R2 908,3 billion, and the average number of trades per day was 87 338. Its market capitalisation amounted to R6 143,2 billion and based on this figure, the JSE Ltd is currently ranked 19th largest stock exchange in the world.\textsuperscript{160}

2 4  THE CURRENT LEGAL FRAMEWORK PERTAINING TO THE FINANCIAL MARKET

2 4 1  Introduction

As noted above,\textsuperscript{161} different aspects of the financial market are regulated by different legislation. The following diagram illustrates an overview of the current regulatory environment pertaining to the South African financial market:


\textsuperscript{160} JSE Limited Annual Report 2009 73.

\textsuperscript{161} See paragraph 1 3 above.
Even though various other legislative measures also exist within the legal framework pertaining to the financial market, the above diagram illustrates the Acts which form the basis of the South African legal framework. As is evident from the above diagram these Acts include: the SSA, the SARB Act, the Banks Act, Companies Act and the FSB Act.

In addition to the current legal framework illustrated above, it is important to note that South Africa is a member of various international institutions committed to providing international best practice with the view of enhancing the regulation of financial markets. Accordingly, an overview of these institutions is also included in the discussion on the current legal framework.

2 4 2 The Securities Services Act

The promulgation of the SSA was necessitated by the realisation that, in view of international developments, South African securities legislation had become outdated
and did not comply with international best practice.\textsuperscript{162} The securities legislation in force at that time comprised the Stock Exchanges Control Act,\textsuperscript{163} the Custody and Administration of Securities Act,\textsuperscript{164} the FMCA\textsuperscript{165} and the Insider Trading Act.\textsuperscript{166} The SSA consequently replaced these four Acts and came into operation in 2005.\textsuperscript{167}

The aim of the SSA is:

“To consolidate and amend the laws relating to the regulation and control of exchanges and securities trading, the regulation and control of central securities depositories and the custody and administration of securities, and the prohibition of insider trading; to provide for the licensing of a clearing house and the approval of nominees; to provide for a code of conduct for authorised users; and to provide for matters connected therewith.”\textsuperscript{168}

Accordingly, the SSA is the most significant and comprehensive legislation regulating the financial market. Furthermore, a vast amount of subsequent legislation pertaining to the financial market was drafted in conformity with the SSA.\textsuperscript{169} The SSA is currently in the process of being amended to address certain needs to accommodate recent domestic legislative developments.\textsuperscript{170} To date, nothing has been published in this regard.


\textsuperscript{163} Act 1 of 1985 (hereinafter “SECA”). This Act modernised and consolidated “the laws relating to the regulation and control of the stock exchanges and the business of stock-brokers and of certain lenders of money against the security of securities.” See Preamble to the Act and Goodspeed, Falkena, Morgenrood & Store The Regulation of Financial Markets (1991) 80.

\textsuperscript{164} Act 85 of 1992. (hereinafter “the CASA”). The CASA provided, \textit{inter alia}, for the registration of a CSD for the custody and administration of securities in terms of a predetermined set of rules. See Preamble to the Act.

\textsuperscript{165} The FMCA provided for the regulation and control of financial markets. See Preamble to the Act.

\textsuperscript{166} Act 35 of 1998 (hereinafter “the Insider Trading Act”). The purpose of the Insider Trading Act was to, \textit{inter alia}, prohibit individuals who have inside information to securities or financial instruments from dealing in such securities or financial instruments, to provide for civil and criminal penalties for such dealings and to empower the FSB to investigate matters relating to such dealing. See the Preamble to the Act.

\textsuperscript{167} Laschinger “Tightening up the Act” 2004 Finance Week 30 30. Also see Anonymous “Managing the future” 1997 Financial Mail 20 20.

\textsuperscript{168} See the Preamble to the SSA.

\textsuperscript{169} For example: the Exchange Rules, Listing Requirements and Guarantee Fund Rules as well as the CSD Rules. See paragraphs 2 5 2 3, 2 5 2 4, 2 5 2 6 and 2 5 2 7 below.

\textsuperscript{170} See Chapter 5 below.
2 4 3  The South African Reserve Bank Act

As stated above, the need for a central bank in South Africa was satisfied by both the Constitution and the SARB Act which provided for the establishment of the SARB.\textsuperscript{171} The SARB Act acknowledges that the SARB is the central bank of South Africa and aims “[t]o consolidate the laws relating to the South African Reserve Bank and the monetary system of the Republic; and to provide for matters connected therewith.”\textsuperscript{172}

2 4 4  The National Payment System Act

The NPS Act is the first of its kind and was necessitated by the need to successfully execute the powers assigned to the SARB in terms of section 10(c)(i) of the SARB Act.\textsuperscript{173} The Act provides for the “management, administration, operation, regulation and supervision of payment, clearing, and settlement system in the Republic of South Africa; and to provide for connected matters.”\textsuperscript{174}

2 4 5  The Banks Act

The need for a Banks Act dates back to 1890 when the Cape Banks suffered severe problems, caused primarily by indiscriminate lending.\textsuperscript{175} The first Banks Act\textsuperscript{176} was promulgated in 1891 and was amended and amplified into its current form. The Banks Act provides for “the regulation and supervision of the business of public companies taking deposits from the public; and to provide for matters connected therewith.”\textsuperscript{177}

\textsuperscript{171} See paragraph 2 3 2 1 above.
\textsuperscript{172} See the Preamble to the SARB Act. For the latest developments pertaining to the SARB Act see footnote 58 above.
\textsuperscript{173} See paragraph 2 3 2 2 above.
\textsuperscript{174} See the Preamble to the NPS Act.
\textsuperscript{175} Goodspeed \textit{et al} \textit{The Regulation of Financial Markets} 78.
\textsuperscript{176} Act 6 of 1891.
\textsuperscript{177} See the Preamble to the Banks Act.
246 The Companies Act

In 1974, the Companies Act 61 of 1973\(^{178}\) came into force to “consolidate and amend the law relating to companies and; to provide for matters incidental thereto.”\(^{179}\) Due to necessary amendments, the Companies Act 71 of 2008\(^{180}\) was promulgated on the 9 April 2009. This new Act will replace the Companies Act, 1973 in its entirety.

The Companies Act, 2008 and its draft Regulations\(^{181}\) were expected to come into operation somewhere in the middle of 2010. However, during the consultation process certain sections of the Act were found to be filled with errors and some of the Regulations were considered *ultra vires*.\(^{182}\) As a result, on 1 March 2010, the Draft Companies Amendment Bill 2010\(^{183}\) was published to, *inter alia*, “correct certain errors resulting in inconsistency, disharmony and ambiguity in the principal Act that could result in misapplication of the principal Act in a manner contrary to its policy.”\(^{184}\) On 28 September 2010, the Minister of Trade and Industry, Dr Rob Davies, deferred the implementation date to 1 April 2011.\(^{185}\) On 10 November 2010, a subsequent draft Companies Amendment Bill [B40 - 2010] was published.

247 The Financial Services Board Act

The FSB Act came into operation in 1990 and its main aim was to provide for the establishment of the FSB.\(^{186}\) The FSB Act provides for “the establishment of a board

\[\text{\footnotesize{\begin{tabular}{l}
179 See Preamble to the Companies Act, 1973.
180 Companies Act 71 of 2008 (hereinafter “the Companies Act, 2008”).
181 The Draft regulations were published in terms of the Government Gazette No. 32832 dated 22 December 2009. For a discussion on these draft Regulations see paragraph 3 3 2 5 below.
183 Hereinafter referred to as the “Companies Amendment Bill, 2010.”
184 The Preamble to the Draft Companies Amendment Bill 2010.
186 Also see paragraph 2 3 3 1 above.
\]
to supervise compliance with laws regulating financial institutions and the provision of financial services; and for matters connected therewith.\textsuperscript{187}

\textbf{2 4 8 International Best Practice}

South Africa is constantly expressing its commitment to align the legal framework pertaining to the financial market with international best practice. In this dissertation, reference will be made to the issues highlighted and recommendations proposed by the institutions providing such best practice. The following are the international institutions providing best practice and of which South Africa is a member: IOSCO, Group of Twenty, International Monetary Fund, World Bank, UNIDROIT, Financial Stability Board and the Bank for International Settlements. These international instruments will now be discussed below.

\textbf{2 4 8 1 IOSCO}

IOSCO was established in 1983 and is an international association of securities regulator. Today, IOSCO is recognised as one of the world's key international standard setting bodies and it has about 180 members who regulate almost 90% of the world's securities markets. The main objective of IOSCO is the cooperation and transfer of expertise, particularly between developed and emerging markets.\textsuperscript{188} As discussed above,\textsuperscript{189} the CMA of the FSB ensures compliance with IOSCO.

\textbf{2 4 8 2 Group of Twenty}

The Group of Twenty\textsuperscript{190} is an informal forum established in 1999, to bring together systemically important industrialised and developing economies to discuss key

\begin{footnotesize}
\begin{enumerate}
\item[187] See Preamble to the FSB Act.
\item[189] See paragraph 2 3 3 2 above.
\item[190] The Group of Twenty (hereinafter “the G20”).
\end{enumerate}
\end{footnotesize}
issues in the global economy. South Africa is a member of the G20 and is represented by the SARB and National Treasury. In April 2009, South Africa, participated in the “G20 London Summit on Financial Markets and the World Economy” which was held against the backdrop of the global economic meltdown. During this summit, the G20 drafted a “Global Plan for Recovery and Reform” and the G20 members committed themselves to “work together with urgency and determination to translate these words into action.”

2483 International Monetary Fund

The International Monetary Fund was established in 1945 and began financial operations in 1947. The IMF is an international organisation which “provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.” South Africa is one of 186 members of the IMF. The IMF has given some significant input as to policy challenges highlighted by the global economic meltdown and reform recommendations which could be of great assistance to South Africa.

Anonymous “South Africa to chair G20 in 2007” http://www.southafrica.info/news/international/g20-2007.htm (accessed 10-10-2010). The relevant recommendations for purposes of this dissertation is discussed in Chapter 4 below.

Group of Twenty “About the G-20” http://www.g20.org/about_about_what_is_g20.aspx (accessed 23-10-2010). The main objective of the National Treasury is to manage the South African governments’ finances and is regulated by the Public Finance Management Act 1 of 1999 (hereinafter “the PFMA”).


Ibid.


International Monetary Fund “About the IMF - Overview” http://www.imf.org/external/about/overview.htm (accessed 22-10-2010).

The relevant recommendations for the purposes of this dissertation is discussed in Chapter 4 below.
2484 World Bank

The World Bank was established to act as a fundamental source of financial and technical assistance to developing countries around the world. It is made up of two institutions, namely, the International Bank for Reconstruction and Development and the International Development Association. Its mission is to “fight poverty with passion and professionalism for lasting results and to help people help themselves and their environment by providing resources, sharing knowledge, building capacity and forging partnerships in the public and private sectors.”

2485 UNIDROIT

UNIDROIT is the International Institute for the Unification of Private Law. Recently, the diplomatic Conference of UNIDROIT held a final session to adopt a Convention on Substantive Rules for Intermediated Securities in Geneva from the 5th to the 9th of October 2009. As a member, South Africa, at the invitation of the Government of Switzerland and under the auspices of UNIDROIT, was represented by Dr Maria Vermaas. The Conference adopted the Convention on 9 of October 2009 and the Convention was given a new name, namely, the UNIDROIT Convention on Substantive Rules for Intermediated Securities (“the Geneva Convention”). On the same day, the Final Act was signed by 37 States, including South Africa and the

200 International Bank for Reconstruction and Development (hereinafter “the IBRD”).
203 In terms of UNIDROIT’s final Convention on Substantive Rules regarding Intermediated Securities, intermediated securities are defined as “securities credited to a securities account of rights or interests in securities resulting from the credit of securities to a securities account.” See UNIDROIT http://www.unidroit.org/english/conventions/2009intermediatedsecurities/conference/conferencedocuments2008/conf11-047rev-e.pdf (accessed 10-10-2010) for the Final Convention.
European Community. The Geneva Convention was signed by only one state, namely, Bangladesh. Accordingly, South Africa has only adopted the Final Act and still needs to ratify the Geneva Convention. The Geneva Convention is currently open for signature at the UNIDROIT headquarters in Rome until such time it enters into force. The Geneva Convention is subject to ratification, acceptance or approval by the States which signed it and any State that does not sign the Geneva Convention is allowed to accede to it at any time. Ratification, acceptance, approval or accession is effected by the deposit of a formal instrument to that effect with the UNIDROIT depository. It is important to note that the Geneva Convention only enters into force on the first day of the month following the expiration of six months after the deposit of the third instrument of ratification, acceptance, approval or accession between the States which have deposited such instruments. As a member of UNIDROIT and signatory of the Final Act, South Africa will now, subsequent to ratification, need to align the current legal framework pertaining to the financial market with the provisions of the Geneva Convention.

2 4 8 6 Financial Stability Board

At the G20 London Summit on Financial Markets and the World Economy Summit in April 2009, the Financial Stability Forum was re-established as the Financial Stability Board. The role of the Financial Stability Board is “to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the

207 Article 40(1) of the Geneva Convention.
208 Article 40(2)-(3) of the Geneva Convention.
209 Article 40(4) of the Geneva Convention.
210 Article 42(1) of the Geneva Convention.
211 Financial Stability Board “Financial Stability Forum re-established as the Financial Stability Board” http://www.financialstabilityboard.org/press/pr_090402b.pdf (accessed 16-10-2010). Due the fact that the Financial Services Board of South Africa is referred to as the “FSB” in this dissertation, no acronym for the Financial Stability Board will be utilised in this dissertation as this may lead to confusion.
interest of financial stability.”212 South Africa is a member of the Financial Stability Board and is represented by the Minister of Finance, namely, Mr Pravin Gordhan.

2487 Bank for International Settlements

The Bank for International Settlements213 was established in 1930 and is an “international organisation which fosters international monetary and financial cooperation and serves as a bank for central banks.”214 The BIS established a Basel Committee on Banking Supervision215 which provides guidance on banking supervisory matters since 1974.216 This Committee does not possess any supervisory authority and its conclusions do not have legal force. However, it formulates broad supervisory standards and guidelines and recommends statements of best practice which authorities may wish to implement.217 South Africa is a member of this Committee and has committed itself to implementing the guidelines circulated by it.

25 THE CAPITAL MARKET

251 Defining the Capital Market

The capital market is not the market for capital as such, but it is the market where financial instruments, which represents either titles or claims to financial capital, trade.218 In the capital market these financial instruments consist of equities and bonds. The capital market can be defined as “a complex of institutions and mechanisms through which funds with terms of more than three years are pooled

213 Bank for International Settlements (hereinafter “the BIS”).
215 Basel Committee on Banking Supervision (hereinafter “BCBS”).
and made available to the private and public sectors.\textsuperscript{219} Public sectors refer to divisions of the economy under the control of the state and private sectors refer to divisions of the economy which are not.\textsuperscript{220}

The capital market consists of both the equity market and the bond market. The terms “equity”, “share” and “stock” are synonymous and for the purposes of this dissertation the term “equity” will be used. “Equity” can be defined as “a financial instrument representing part ownership in a corporate entity.”\textsuperscript{221} The significance of the equity market is that it allows investors to earn good returns on money invested and it can also be utilised to gain control over companies by buying their majority shareholding or to acquire companies in full by buying their full shareholding.\textsuperscript{222} It also provides companies with the opportunity to list their shares on the equity market in order to, \textit{inter alia}, obtain capital and/or to increase liquidity of shares.\textsuperscript{223}

A “bond” can be defined as “a debt instrument that promises that the issuer will pay the holder interest over a certain period of time and repay the face value at maturity.”\textsuperscript{224} The significance of the bond market lies in the fact the market makes it possible for investors, who wish to invest their funds in bonds, to buy and sell long-term instruments at any time. It also provides the means to government (at national and local government level) to issue bonds to finance their activities and enables large companies to issue bonds to secure finance for their activities or projects.\textsuperscript{225}

The capital market can be divided into various sub-markets and are illustrated in the diagram below.

\begin{itemize}
\item \textsuperscript{219} \textit{Ibid.}
\item \textsuperscript{220} Van Zyl \textit{et al Understanding South African Financial Markets} 485.
\item \textsuperscript{221} 475.
\item \textsuperscript{222} Kriek \& Beekman \textit{Fundamentals of Finance} 24.
\item \textsuperscript{223} \textit{Ibid.}
\item \textsuperscript{224} Van Zyl \textit{et al Understanding South African Financial Markets} 469. As opposed to an “issuer” referred to in paragraph 2 2 above, “issuer” in this context refers to the entity who is obliged on a security, bond or financial asset. “Holder” refers to the holder of the bond. “Face value is the same as “nominal value” and “nominal value” is the value attached to a security at time of issue and not the value of the current market price of the security.
\item \textsuperscript{225} Kriek \& Beekman \textit{Fundamentals of Finance} 23.
\end{itemize}
The primary market provides for the place where securities are issued and offered for the first time and the secondary market is the place where the holders of securities trade once they have been issued.\textsuperscript{226} The issuance and offer of securities are conducted in the primary market by means of initial listing\textsuperscript{227} of a company or through the issuance of securities by an already listed company on an exchange. These securities may subsequently be traded on the secondary market for the purposes of transfer of ownership in the securities without affecting the capital structure of the issuing company.\textsuperscript{228}

Trading activities in the primary market are governed by specific legislation and enabling legislation. Specific regulation refers to the rules, directives, listing requirements etcetera, as imposed by an exchange.\textsuperscript{229} Enabling legislation refers to the CSD Rules.\textsuperscript{230}

\begin{footnotesize}
\begin{enumerate}
\item Van Zyl et al Understanding South African Financial Markets 326. Also see: Madura Financial Institutions and Markets 8\textsuperscript{th} ed (2008) 3.
\item For a discussion on the Exchange Listing Requirements see paragraph 2 5 2 6 below.
\item Van Zyl et al Understanding South African Financial Markets 326.
\item Ibid.
\end{enumerate}
\end{footnotesize}
The secondary market can be divided into four markets.\textsuperscript{231} Firstly, the formal market which provides for the trading of securities listed on an exchange (the JSE). Secondly, the OTC market which provides for trading of securities which are not listed on a formal exchange. Thirdly, trades in listed shares off exchange. “Off exchange” or “off market” refers to trading of securities which is not concluded through an exchange and is reported by the seller and purchaser of the securities to the relevant CSD Participant for settlement through the CSD.\textsuperscript{232} Finally, direct trades between buyers and sellers without the intermediation of brokers.

As is evident from the above, the first sub-market facilitates trading of listed securities. This sub-market is by implication subject to the same regulation as the primary market. By contrast, the other three sub-markets (which provide for the trading of securities over-the-counter-market, “off exchange” and directly between buyers and sellers without the intermediation of brokers) may be free of supervision and regulation or may be subject to general legislation.\textsuperscript{233} However, in practice, market participants\textsuperscript{234} enter into a contract regulating the terms and conditions of their agreement.

\textbf{2.5.2 \hspace{1em} Legal Framework Pertaining to the Capital Market}

\textbf{2.5.2.1 \hspace{1em} Introduction}

The legal framework pertaining to the capital market currently consists of a number of legislative measures enacted to regulate different aspects. These include the SSA, the CSD Rules and Directives as well as the Exchange Rules, Directives, Listing Requirements and Guarantee Fund Rules.\textsuperscript{235}

\begin{flushleft}
\textsuperscript{231} Ibid.
\textsuperscript{233} Goodspeed et al \textit{The Regulation of Financial Markets} 6 and Kriek & Beekman \textit{Fundamentals of Finance} 19.
\textsuperscript{234} For a definition of “market participant” see footnote 85 above.
\textsuperscript{235} Despite the merger of the two exchanges the JSE and BESA currently each still utilises its respective Exchange Rules, Directives, Listing Requirements (“Listing Disclosure Requirements” in the case of BESA) and Guarantee Fund Rules. The JSE and BESA are currently in the process establishing the need for consolidation of these legislative measures.
\end{flushleft}
Section 3(1) of the SSA provides the following:

“This Act applies to –

(a) regulated persons and the securities services provided by regulated persons;

(b) issuers;

(c) clients;

(d) market abuse;\(^{236}\) and

(e) matters incidental to the matters referred to in paragraphs (a) to (d).” (my underlining)

Since equities and bonds are included in the definition of “securities”\(^{237}\) in terms of the SSA and by implication included in the definition of “securities services,”\(^{238}\) as provided for in section 3(1) of the SSA, the SSA accordingly applies to the regulation of equities and bonds and therefore, the capital market. It is important to note that the existence of an “exchange”\(^{239}\) for the issuance and trading of listed securities in the capital market means that Chapter Three of the SSA\(^{240}\) is also applicable to the legal framework pertaining to the capital market. This operation of an exchange and the consequent application of Chapter Three of the SSA is not always the legal position, as for example, in the money market.\(^{241}\)

2.5.2.3 CSD Rules and Directives

The SSA\(^{242}\) requires an application for a CSD license to be accompanied by a copy of proposed depository rules. These proposed rules must comply with section 39 of

\(^{236}\) “Market abuse” relates to insider trading, as well as manipulative, improper, false or deceptive practices of trading, and false, misleading of deceptive statements, promises and forecasts.

\(^{237}\) For the definition of “securities” see paragraph 2.2 above.

\(^{238}\) For the definition of “securities services” see paragraph 2.2 above.

\(^{239}\) For the definition of “exchange” see paragraph 2.2 above.

\(^{240}\) S 8-10 of the SSA which sets out the rules pertaining to the Licensing of an Exchange.

\(^{241}\) See paragraph 2.6.2.2 below.

\(^{242}\) S 30(c)(i) of the SSA.
the SSA and must be enforced. In compliance with the SSA, the CSD published such CSD Rules in 1998. The CSD Rules are delegated legislation and any changes to the CSD Rules must be conducted in compliance with the SSA.

There is no express provision in the SSA requiring a CSD to enact directives. It provides that a CSD “may” issue directives. The CSD, consequently, elected to enact various directives pertaining to equities, bonds and money market instruments. The SSA requires the CSD Rules to provide for the purposes for which a CSD may issue Directives as well as the process of making such Directives. As opposed to the CSD Rules, any changes to the CSD Directives must be conducted in accordance with the CSD Rules. It must be noted that in case of a conflict between the CSD Rules and the CSD Directives, the CSD Rules prevail.

**2524 The Exchange Rules**

In terms of the SSA, each application for an exchange license must be accompanied by a copy of proposed Exchange Rules. “Exchange Rules” are rules

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243 S 39(1) of the SSA requires the CSD Rules to be consistent with the SSA. S 39(2) sets out the specific requirements with which the CSD Rules must comply. S 39(3) provides that, subject to the approval of the Registrar, a CSD may make rules additional to the rules in s 39(2). S 39(4) states that the CSD Rules are binding on the CSD, a CSD Participant, and an issuer of securities deposited with the CSD and their officers and employees, and clients.

244 S 33(a) of the SSA. See CSD Rule 2.7. In compliance with the SSA, the Rules of the CSD contain regulatory measures pertaining to, inter alia, CSD Participation, Duties of Participants, and Disciplinary Procedure.

246 See s 33(b) and s 61 of the SSA. The procedure of any amendments to the CSD Rules are set out in CSD Rules 2.7 – 2.10.

247 S 33(d) of the SSA. These various CSD Directives are hereinafter collectively referred to as “the CSD Directives.” The CSD Directives pertains to; inter alia, Best Practice for Off-Market Trades (Directives SCV and SFA), Requirements for financial soundness (Directive SAB), Dematerialisation and Rematerialisation Procedures (Directives SBA and SBB) and Fines (Directives SCP and SFB). See paragraphs 2525 and 2526 below. Also see Strate Limited “Directives” http://www.strate.co.za/rules%20regulations/directives.aspx (accessed 28-10-2010) for a list of the current Strate Directives.

249 S 33(o) of the SSA. CSD Rule 2.11 provides that the Controlling Body of the CSD may issue Directives in respect of any or all matters relating or incidental to the SSA and the CSD Rules. In terms of s 1 of the CSD Rules the Controlling Body is the board of directors of the CSD. CSD Rules 2.12-2.17 sets out the process of making the CSD Directives.

251 CSD Rule 2.6.

252 S 8(c)(i) of the SSA.
made by an exchange in accordance with the SSA. The SSA sets out the requirements regarding the requisite content of exchange rules. These Exchange Rules must also be enforced by the relevant exchange. Accordingly, both the JSE and BESA have enacted such rules and they set out the exchange rules pertaining to equities and bonds respectively.

252.5 The Exchange Directives

There is no express provision in the SSA requiring an exchange to enact directives; it provides that an exchange “may” issue directives. Both the JSE and BESA elected to enact various directives. The purpose of these directives is to achieve the objectives of the exchange by providing the procedures necessary to establish and regulate fair and efficient markets and to ensure that the business of the exchange is carried out in an orderly manner and with due regard to the objectives of the SSA.
2526 The Exchange Listing Requirements

In terms of the SSA, an exchange must make listing requirements which must comply with SSA and these requirements must be enforced by the relevant exchange. Section 12 sets out the requisite requirements regarding the content of the exchange’s rules listing requirements with which the exchange must comply.

Accordingly, the JSE published Listing Requirements and are currently updated to Service Issue 13, February 2010. BESA published “Listing Disclosure Requirements” as opposed to the JSE’s Listing Requirements. It is submitted that BESA’s Listing Disclosure Requirements do not as extensive ambit as provided for by the JSE Listing Requirements, as it is confined to regulate only “disclosure requirements” and, by implication, do not cover issues outside the scope of listing disclosure. As a result of the merger, the JSE is currently in the process of finalising new Listing Requirements consolidating the JSE Listing Requirements and the BESA Listing Disclosure Requirements. These Listing Requirements are expected to come into operation in 2011.

263 S 12 of the SSA.
264 Ibid.
265 S 11 (1)(a) of the SSA.
266 Of the SSA.
267 See s 12 of the SSA.
268 JSE Limited Listing Requirements Service Issue 13 February 2010 (hereinafter “the JSE Listing Requirements”). The JSE listing requirements contain regulatory measures pertaining to, inter alia, Conditions for listing, Methods and procedures of bringing securities to listing and Pre-listing statements.
269 Bond Exchange of South Africa Listing Disclosure Requirements January 2009 (as amended to date). Hereinafter “the BESA Listing Disclosure Requirements.” The BESA Listing Disclosure Requirements provide for the minimum disclosure which investors and their professional advisors would reasonably require for the purpose of making an informed assessment of the nature and state of an issuer’s business. It also provide that issuers engaged in specialised industries (e.g. banking) or specialised issues (e.g. securitisation) may decide to, or be required by BESA, to provide additional information, in other words, be subject to supplementary disclosure requirements.
2527 The Exchange Guarantee Fund Rules

The SSA\textsuperscript{271} obliges an exchange to create a guarantee or compensation fund in order to enable it to provide compensation to clients. It also provides 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.”\textsuperscript{272} The purpose of an exchange fund is to provide for a fund from which claims, up to an amount specified in the rules of such fund in respect of liabilities arising prior to the default of a member, can be paid.\textsuperscript{273}

Accordingly, the JSE Guarantee Fund was established by the JSE and in order to provide a legal framework regulating the JSE Guarantee Fund, the JSE Guarantee Fund Rules\textsuperscript{274} were enacted. The JSE Guarantee Fund is a Fund consisting of all the assets and liabilities incurred by the trustees\textsuperscript{275} of the JSE Guarantee Fund Trust.\textsuperscript{276} A Guarantee Fund was also established by BESA and is also a duly registered legal trust.\textsuperscript{277} As opposed to the JSE Guarantee Fund Rules, the BESA Guarantee Fund is regulated in terms of the BESA Rules.\textsuperscript{278}

\textsuperscript{271} S 9(1)(e) of the SSA.
\textsuperscript{272} S 17(1) of the SSA.
\textsuperscript{273} JSE Equities Rule 2.130.1.1.
\textsuperscript{274} JSE Guarantee Fund Rules July 2005 (as amended to date). Hereinafter “the JSE Guarantee Fund Rules.”
\textsuperscript{275} In terms of s 3 of the JSE Guarantee Fund Rules, trustees are the “independent non-stockbroking members of the controlling body of the JSE.” In terms of s 1 of the JSE Equities Rules, the controlling body of the JSE is the “board of directors of the JSE which is the governing body managing the affairs of the JSE.”
\textsuperscript{276} Rule 2.1 of the JSE Guarantee Fund Rules.
\textsuperscript{277} For a definition of “Guarantee Fund” see BESA Rules A 1.3.
\textsuperscript{278} BESA Rules C8.
2 6 THE MONEY MARKET

2 6 1 Defining the Money Market

Unlike the capital market, short-term securities are traded in the money market. Short-term securities mature within one year or less. Money market securities consist of a variety of instruments, such as:

- Bankers’ acceptances;^{279}
- Promissory notes;^{280}
- Treasury bills;^{281}
- Negotiable certificate of deposits;^{282}
- SARB debentures;^{283}
- Land Bank bills;^{284}

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^{279} A banker’s acceptance is a tradable short-term debt instrument, formally defined as a bill of exchange drawn on and accepted by a bank. A bill of exchange is “an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to a specified person or his order, or to bearer.” See s 2(1) of the Bill of Exchanges Act 34 of 1964. Also see Van Zyl et al Understanding South African Financial Markets 244.

^{280} A promissory note is “an unconditional promise in writing made by one person to another, engaging to pay on demand or at a fixed determinable future time, a certain sum of money, to a specified person or his order.” The difference between a promissory note and a banker’s acceptance is that the promissory note represents a promise to pay whereas a banker’s acceptance represents an order to pay. Also see Van Zyl et al Understanding South African Financial Markets 485 & 264.

^{281} A treasury bill is a short-term debt obligation of central government having a maturity of up to one year. In South Africa the maturity date is between three and six months. Maturity date refers to the “date when a financial contract will expire.” A treasury bill differs from a bill of exchange and a promissory note in that it represents a charge on the revenues and assets of the Republic of South Africa rather than a bank. See Fourie et al Student Guide to the South African Financial System 166 & 167 and Van Zyl et al Understanding South African Financial Markets 481 & 490.

^{282} A negotiable certificate of deposit (hereinafter a “NCD”) is a “fixed deposit receipt issued by a bank that is negotiable in the secondary market as a financial asset.” The issuer of the NCD undertakes to pay the amount of the deposit plus the interest to the holder of the NCD on the maturity date. See Falkena, Fourie & Kok The South African Financial System (1995) 135.

^{283} A South African Reserve Bank debenture is short-term transferable security issued by the SARB as a supplementary facility for banking institutions to invest surplus short-term funds. The principal amount plus interest is paid by the SARB on the specified redemption date. Redemption date is the date on which partial or full return of the debt or securities to the issuer in exchange for a cash value takes place. See Van Zyl et al Understanding South African Financial Markets241 and Strate Limited “Glossary” http://www.strate.co.za/glossary.aspx (accessed 10-10-2010).

^{284} A Land Bank Bill is a “short-term discount security issued by the Land and Agricultural Bank of South Africa.” The purpose of a Land Bank Bill is to extend short-term financing to agricultural cooperatives that in turn use these funds to purchase agricultural products from farmers and
• Commercial paper;\textsuperscript{285}
• Repurchase agreements;\textsuperscript{286}
• Bridging bonds;\textsuperscript{287}
• Capital project bills;\textsuperscript{288}
• Transnet Limited coupon stocks;\textsuperscript{289} and
• Call bonds.\textsuperscript{290}

The significance of the money market is that it provides investing opportunities to investors, such as companies, who only have funds available for investing for short periods of time.\textsuperscript{291} In turn, it provides access to short-term financing to companies experiencing short-term cash shortages.\textsuperscript{292} The money market also provides SARB with the mechanism to regulate liquidity.\textsuperscript{293}

\subsection*{2.6.2 Legal Framework Pertaining to the Money Market}

\subsubsection*{2.6.2.1 Introduction}

The legal framework pertaining to the money market is different to the legal framework pertaining to the capital market. Unlike the capital market, the money market is an OTC market and is not regulated by specific legislation (i.e. the rules of production necessities from manufacturers and suppliers. See Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 260.

\textsuperscript{285} A commercial paper is a security issued by corporate and other non-banking institutions to acquire working capital. Working capital refers to the amount by which current assets exceed current liabilities. See Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 471& 261.

\textsuperscript{286} A repurchase agreement is the sale of assets and a simultaneous agreement to repurchase the equivalent asset at a future date or on demand, for the original value plus a return on the use of the cash. See Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 252.

\textsuperscript{287} A bridging bond is a short-term unsecured security issued by a public or semi-public sector body to acquire bridging finance. See Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 469.

\textsuperscript{288} A capital project bill is a short-term security issued by large companies or public corporations to raise funds for the maintenance of capital projects. See Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 265.

\textsuperscript{289} A Transnet Limited coupon stock is an unsecured short-term security issued by Transnet. See Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 266.

\textsuperscript{290} A call bond is a negotiable short-term commercial paper issued by large corporations. See Van Zyl \textit{et al} \textit{Understanding South African Financial Markets} 267.

\textsuperscript{291} Kriek & Beekman \textit{Fundamentals of Finance} 22.

\textsuperscript{292} Ibid.

the JSE).

In the money market, great reliance is placed on mutual agreement, for instance, by way of contract, between the parties to money market transactions. However, in some circumstances, the JSE Rules may apply in addition to mutual agreements. This is due to the fact that the majority of brokers operating in the money market are usually members of the JSE. The JSE Equities Rules defines a “member” as an “equities member, which is a category of authorised user admitted to membership of the JSE under these rules.” These members are subject to the JSE Rules and therefore, the Rules apply to the money market transactions they facilitate. Other legislative measures in the money market, in addition to mutual agreements and on occasion the JSE Exchange Rules, are Chapter IV of the SSA, the CSD Rules and Directives and the SARB Operational Notice.

2 6 2 2 Latest Developments

Strate recently added electronic settlement of money market instruments to its portfolio of services. All money market securities are now issued and traded electronically and are kept in a central individual ownership register held by Strate, known as a Securities Ownership Register. This initiative was necessitated by the high volume of money market securities in circulation, coupled with custody requirements and the associated risk of loss, theft or fraud of bearer documents. On 28 October 2009, the first dematerialised money market instrument was successfully issued, traded and settled electronically. On 5 March 2010, the entire money market was fully dematerialised and electronic. Existing certificated money

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294 As discussed in paragraph 2524 above.
295 As defined in terms of s 1 of the SSA. For a definition of authorised user see paragraph 22 above.
296 S 1 of the JSE Equities Rules.
298 As mentioned in paragraph 234 above.
299 Securities Ownership Register (hereinafter “a SOR”). See Strate Limited “Money Markets” http://www.strate.co.za/products%20services/money%20markets/default.aspx (accessed 10-10-2010). In terms of S 1.2 of the CSD Rules a SOR refers to the central securities account comprising the various money market securities accounts opened and maintained by CSD Participants.
market instruments were not dematerialised. Only new money market securities were issued into the dematerialised environment on a phased-in basis.\(^\text{302}\)

It is important to note that unlike the capital market, where Strate mainly has the functions of settlement of equities and the settlement and clearing of bonds,\(^\text{303}\) Strate has a much bigger role to play in the money market. Strate not only handles the settlement functions, but also the trade reporting,\(^\text{304}\) matching,\(^\text{305}\) clearing,\(^\text{306}\) commitment\(^\text{307}\) and settlement functions with regard to money market instruments.\(^\text{308}\)

In order to assist Strate in performing these functions, Strate has made provision for “business partners.” In terms of the CSD Directives\(^\text{309}\) a business partner is “an entity which is not a Participant and which interfaces with the CSD to perform an essential market function in the issue, investment and settlement of money market instruments.” Unlike a Participant, a business partner may choose to take on several roles in the money market securities settlement system, for example, it can be an issuer, issues agent or trader. A business partner may, however, not take on one of the single roles available in the money market securities settlement system. These include the CSD role reserved for Strate and the National Numbering Agency reserved for the JSE. Of utmost importance are the other two single roles, which


[303] The additional clearing function of bonds (as opposed to equities) by Strate, dates back to the BESA clearing and settlement house, UNEXcor, before its merger with STRATE and Central Depository Limited. See paragraph 2 3 4 above.

[304] “Trade reporting” refers to the reporting of trades resulting in change of ownership in securities.

[305] “Matching” refers to “the process for comparing the trade or settlement details provided by counterparties to ensure that they agree with respect to the terms of the transaction.” See Bank for International Settlements “Glossary” at http://www.bis.org/publ/cpss00b.pdf?noframes=1 (accessed 23-10-2010).

[306] “Clearing” is defined by Strate as the “process, in conjunction with settlement, of determining accountability for the exchange of money and Securities between counterparties to a transaction. See Strate Limited “Glossary” http://www.strate.co.za/glossary.aspx (accessed 10-10-2010).

[307] “Commitment” is defined by Strate as “An electronic instruction that constitutes an undertaking by a Participant to settle a transaction in uncertificated Securities on Settlement Date.” See Strate Limited “Glossary” http://www.strate.co.za/glossary.aspx (accessed 10-10-2010). Also see paragraph 3 2 below.

[308] With regard to these functions, the CSD Directive “SGC” is of great importance.

[309] CSD Directive SGC.
relates to the two roles to be played by SARB in the money market securities settlement system. These two roles include the role of the SARB SAMOS system and the SARB BSD.\textsuperscript{310}

\textbf{2 6 2 3 Chapter IV of the Securities Services Act}

The definition of “securities” in the SSA excludes money market instruments from the application of the SSA.\textsuperscript{311} However, money market instruments are included in the definition of “securities” for purposes of Chapter IV of the SSA and, therefore, Chapter IV forms part of the legal framework pertaining to the money market. Chapter IV deals with the custody and administration of securities. In agreement with this position, it should be kept in mind that the money market is an OTC market and therefore, there is no manifestation of an exchange as such, except where members of the JSE comes into play.\textsuperscript{312} Accordingly, Chapter Three of the SSA, dealing with the licensing of an exchange is not applicable to the legal framework pertaining to the money market.

\textbf{2 6 2 4 CSD Rules and Directives}

Since all money market instruments have been dematerialised in Strate, the CSD Rules applies to the legal framework pertaining to the money market, and in particular, CSD Rule 7. The main purpose of CSD Rule 7 is to provide for the transfer of ownership in money market instruments. The CSD Rule 7 provides for the existence of such a SOR\textsuperscript{313} in which all money market securities issued and traded are electronic and kept.\textsuperscript{314}

\begin{flushright}
\textsuperscript{310} CSD Directive SGB.
\textsuperscript{311} See s 1 of the SSA and paragraph 2 2 above.
\textsuperscript{312} See paragraph 2 6 2 1 above.
\textsuperscript{313} As noted in paragraph 2 6 2 2 above.
\textsuperscript{314} See paragraph 2 6 3 1 above. The CSD Rule 7 provides for the existence of such a SOR and it regulates the Creation and Deposit of Securities, Money Market Securities Accounts, the Transfer of Money Market Securities, Commitment to Settle, Settlement of Transactions, The Pledge or Cession to Secure a Debt, Debit Balances and Withdrawal.
\end{flushright}
Similar to the CSD Directives pertaining to equities and bonds,315 Strate issued Directives dealing with money market securities and the money market securities settlement system in 2008.316

**2625 South African Reserve Bank Operational Notice**

One of various roles of the SARB in the financial market entails that it regulates the supply of bank reserves in order to achieve its interest rate.317 SARB achieves its interest rate by maintaining appropriate liquidity in the money market followed by a demand for refinancing through which the SARB can influence market rates.318 The operations of the SARB in influencing liquidity entail liquidity providing (refinancing operations) and liquidity draining (open-market transactions).319

The SARB provides liquidity to the market by means of repurchase transactions.320 The SARB drains liquidity from the market by means of SARB debentures,321 longer-

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315 As noted in paragraph 2523 above.
317 As mentioned in paragraph 2323 above. Also see Van Zyl et al Understanding South African Financial Markets 54.
term reverse repos, foreign swap transactions and the outright sales of bonds.

Ultimately, the SARB uses open-market sales of securities and open-market purchase of securities to regulate liquidity. Open-market operations in the money market are regulated by the South African Reserve Bank Operational Notice pertaining to the Money Market Operations conducted by the FMD of the South African Reserve Bank.

2 7  THE DERIVATIVE MARKET

2 7 1  Defining the Derivative Market

The derivative market is the market for derivative instruments. A derivative instrument can be defined as “any financial instrument or contract that creates rights and obligations and that derives its value from the price or value, or the value of which may vary depending on a change in the price or value, of some other particular product or thing.”

The derivative market is the most complex and often incomprehensible market, not only in South Africa, but all over the world. Over the past two years, derivatives have made sensational headlines. It has been the misuse of derivatives which have been taken to blame for the global economic meltdown.

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1. The SARB sells bonds in terms of repurchase agreements and pays the interest rates tendered by the counterparties on the cash it withdraws from the market. Repurchase agreements are discussed in footnote 286 above.
2. The SARB swaps US dollars South African rands to drain liquidity for on a temporary basis. For a definition of a foreign exchange swap see paragraph 2 7 1 2 above.
3. The SARB sells bonds to drain liquidity permanently from the market. See Van Zyl et al Understanding South African Financial Markets 55.
4. The sale of open-market securities creates a shortage of cash reserves in the banking system (liquidity draining) which in turn forces banks to make use of the SARB refinancing system. See ibid.
5. The purchase of open-market securities are made for the purpose of supplying cash reserves to the banking system (liquidity providing). See ibid.
6. South African Reserve Bank Operational Notice Pertaining to the Money Market Operations conducted by the Financial Markets Department of the South African Reserve Bank dated 30 August 2010 (hereinafter “the SARB Operational Notice”). The SARB Operational Notice states the Types of Open-market Transactions, Eligible securities, the Tender Processes, Delivery and Settlement of Securities, Margin Maintenance and the Legal and Accounting Framework. Therefore, when examining the legal framework pertaining to the Money Market, regard must be had to the Operational Notice.
7. S 1 of the SSA.
The derivative market includes exchange-traded derivative instruments and OTC (or off-market) derivative instruments. Exchange-traded derivative instruments are derivative instruments that are traded on a formal exchange and OTC derivative instruments are derivative instruments that are traded on the OTC market. The derivative market includes the following derivative instruments:

2.7.1.1 Futures and Forwards

“Futures” or a “futures contract” refers to an exchange-traded contract to buy or sell a precise quantity of a certain underlying financial instrument at a precise price, place and time in the future. “Forwards” or “forward contracts” are the equivalent in the OTC market. Futures can be classified as financial or non-financial. Financial futures relate to underlying markets that are themselves financial instruments and non-financial relates to futures on soft commodities. Soft commodities are, for example, maize or wheat, as opposed to hard commodities which are for example metals and oil.

2.7.1.2 Swaps

A swap can be defined as “an agreement to exchange cash flows at a predetermined rate or reference rate for a defined period between two parties, often using a net cash settlement of the respective cash flows.” Broad varieties of swaps exist and include:

- interest rate swaps,
- interest rate swaps and investments,

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329 For the meaning of OTC and off-market see paragraph 2.5.1 above.
331 388.
332 Ibid.
333 389.
334 Ibid.
335 408.
336 An interest rate swap is “an agreement between two parties to settle the net difference between two interest rate payments on a notional amount of money, with one party agreeing to pay a fixed rate of interest and the other a floating rate.” See Van Zyl et al Understanding South African Financial Markets 408.
• foreign exchange swaps;\textsuperscript{338}
• Rand Overnight Deposit Swaps;\textsuperscript{339} and
• credit swaps.\textsuperscript{340}

\textbf{2.7.1.3 Options}

An option can be defined as “a contract which gives the holder the right, but not the obligation, to buy a specific quantity of an asset at an agreed price at some point or points in the future.”\textsuperscript{341} The buyer may therefore choose whether to exercise the right to buy or sell.\textsuperscript{342}

\textbf{2.7.2.4 Warrants}

Warrants are a type of exchange listed option and can be categorised as covered or uncovered warrants. “Covered warrants” refer to the issue of warrants by a company on its own shares as opposed to “uncovered warrants” which refer to listing of warrants by a third party. Warrants are simply options in another name. The only difference between options and warrants are that warrants are traded on a stock exchange and options are traded on a derivative exchange.\textsuperscript{343}

\textsuperscript{337} An interest rate swap can also be used to protect the return on an investment. This can be done by the investing entity paying a floating rate to the swap counterparty and then in return receiving a fixed rate. A discussion on floating and fixed rates will be too broad for the purposes of this dissertation. See Van Zyl \textit{et al.} \textit{Understanding South African Financial Markets} 410.

\textsuperscript{338} A foreign exchange swap is a swap that requires the parties to “physically exchange principal amounts of two currencies at the beginning of the swap’s life, with are-exchange of these amounts at the end, including an adjustment to reflect the interest rate differential of the two currencies concerned.” See Van Zyl \textit{et al.} \textit{Understanding South African Financial Markets} 411.

\textsuperscript{339} A Rand Overnight deposit are used to hedge borrowings or investments where the underlying rate of interest is the daily call rate charged or paid by banks. Hedging refers to action taken to protect against the risk of an adverse outcome. See Van Zyl \textit{et al.} \textit{Understanding South African Financial Markets} 411 & 478.

\textsuperscript{340} Credit swaps consist of credit default swaps and total return swaps. A credit default swap entails that a fee is paid by the buyer to the seller in relation to protection from a credit default event. In such a way compensation will be received by the investor in the event of default of obligations by the insurer. A total return swap allows investors to take a position in an underlying asset without actually owing it. The investor agrees to periodically pay a funding rate in return for receiving the return on an underlying asset. Should default of the reference asset occur, the investor must either compensate the swap counterparty or take delivery of the defaulted asset. See Van Zyl \textit{et al.} \textit{Understanding South African Financial Markets} 413.

\textsuperscript{341} Van Zyl \textit{et al.} \textit{Understanding South African Financial Markets} 414.

\textsuperscript{342} \textit{Ibid.}

\textsuperscript{343} \textit{Ibid.}
2.7.2 Legal Framework Pertaining to the Derivative Market

2.7.2.1 Introduction

In the derivative market, both listed and unlisted derivative instruments can be traded. The trading of listed derivatives is regulated by the SSA and the JSE Derivatives Rules and Directives as well as the Yield-X Rules and Directives.\textsuperscript{344} The trading of unlisted derivatives is conducted by entering into OTC transactions and it is regulated by the International Swaps and Derivatives Association Master Agreement of 2002,\textsuperscript{345} as produced by the International Swaps and Derivatives Association.\textsuperscript{346} In addition to the above, the CSD Rules and Directives also form part of the legal framework pertaining to the derivative market.

2.7.2.2 The Securities Services Act

Derivative instruments are included in the definition of “securities”\textsuperscript{347} and, therefore, the SSA forms part of the legal framework pertaining to the derivative market.\textsuperscript{348} It should also be noted that the existence of an exchange which facilitates the issuance and trading of listed derivative instruments leads to the specific applicability of Chapter Three of the SSA in the derivative market.\textsuperscript{349}

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\textsuperscript{344} The JSE and Yield-X Derivatives Rules and Directives are discussed in paragraph 2.7.2.4 below.

\textsuperscript{345} The ISDA Master Agreement incorporates standard term regulating the trading of unlisted derivative instruments. The ISDA Master Agreement must, however, be read with the SSA in order to ensure that such transactions take place within the South African regulatory bounds. See Davids and Modise “The Regulation of Derivatives in South Africa” http://www.bowman.co.za/LawArticles/Law-Article.asp?id=-1051746687 (accessed 11-10-2010).

\textsuperscript{346} International Swaps and Derivatives Association (hereinafter “the ISDA”). The ISDA is an international association which aim is to encourage the prudent and efficient development of privately negotiated derivatives. See International Swaps and Derivatives Association “About ISDA - Mission“ http://www.isda.org/ (accessed 25-10-2010).

\textsuperscript{347} For a definition of “securities” see paragraph 2.2 above.

\textsuperscript{348} The application of s 3 of the SSA in the derivative market is justified by the same reasons as the capital market. See paragraph 2.5.2.2 above.

\textsuperscript{349} See paragraph 2.5.2.2 above.
The electronic settlement of derivatives through the CSD is subject to the legal framework of the CSD, which includes the CSD Rules and Directives.  

The Exchange Rules

SAFEX is an exchange division of the JSE which deals in derivatives contracts. SAFEX was expanded to include two separate entities in 2001. The entities are the JSE SAFEX Equities Derivatives, which provides a platform for the trading of futures and/or options and the JSE SAFEX Agricultural Products, which provides for the trading of commodities derivatives. The commodities traded include corn, grain, oils, maize and precious metals such as gold (bullion) and platinum. The trading of derivative instruments on SAFEX is subject to the JSE Derivatives Rules.

The Yield-X exchange is another division of the JSE which provides a trading platform for the trading of interest rate products and cash bonds. Trading of financial instruments on Yield-X is subject to the Yield-X Rules implemented by the JSE Surveillance department.

For discussion on the CSD Rules and Directives see paragraph 2 5 2 3 above. The directives pertaining to the derivative market include the general directives of the CSD and specific directives pertaining to derivatives. The specific directives include the directives on Yield-X trade settlement (Derivative SEA) and a Fines Schedule for the settlement of Yield-X trades (Derivative SEB).

See paragraph 2 3 5 2 above.


“Precious metals” as defined in s 1 of the Precious Metals Act 37 of 2005.

JSE Limited Derivatives Rules 1 December 2010 (as amended to 27 October 2010). Hereinafter “the JSE Derivatives Rules.” These Rules provide for the regulation of, inter alia, Trading, Defaults and Management of members’ and clients’ funds in the SAFEX environment. These Rules were also recently amended, together with the JSE Equities Rules, to include the reporting and assistance by the JSE Surveillance department. See JSE Derivative Rule 3.276


JSE Limited Yield-X Rules January 2005 (as amended to 27 October 2010). Hereinafter “the Yield-X Rules.” These Rules provide for the regulation of, inter alia, Trading, Clearing and Settlement in the Yield-X environment. These Rules were also recently amended, together with the JSE Equities Rules, to include the reporting and assistance by the JSE Surveillance department. See Yield-X Rules 4.15.
JSE. In the BESA environment the BESA Rules, especially Part E, apply to derivatives instruments traded through BESA.\textsuperscript{358} The JSE Yield-X was established in direct competition to BESA as it enables the JSE to provide for the trading of, not only equities, but bonds as well. To date it is uncertain what effect the consolidation of the JSE and BESA will have on the trading of Yield-X products.

\textbf{2.7.2.5 The Exchange Directives}

The legal specific frameworks of the SAFEX and Yield-X also include Directives. SAFEX is subject to the JSE Derivatives Directives\textsuperscript{359} and Yield-X to the Yield-X directives.\textsuperscript{360}

\textbf{2.7.2.6 The JSE Fidelity Fund Rules}

As noted above,\textsuperscript{361} the SSA obliges an exchange to create a guarantee or compensation fund in order to enable it to provide compensation to clients. The JSE elected to establish a separate fund, in terms of the JSE Derivatives Rules, to operate in the derivative market.\textsuperscript{362} This fund is known as the JSE Fidelity Fund and it consists of all the assets and liabilities incurred by the trustees\textsuperscript{363} of the JSE Derivatives Fidelity Fund Trust.\textsuperscript{364}

\begin{footnotesize}
\begin{itemize}
\item Part E of the BESA Rules sets out the Rules regarding the Derivatives Traders Association. Also see paragraph 2.3.5.3 above.
\item JSE Limited Derivatives Directives August 2005 (as amended to 11 October 2010). Hereinafter “the JSE Derivatives Directives.” The JSE Derivatives Directives include directives pertaining to, \textit{inter alia}, capital adequacy requirements of members, trading periods and times and notification of transactions.
\item JSE Limited Yield-X Directives January 2005 (as amended to 11 October 2010). Hereinafter “the Yield-X Directives.” The Yield-X derivatives directives include directives pertaining to, \textit{inter alia}, trading, settlement and prescribed agreements.
\item See paragraph 2.5.2.7 above.
\item Rules 1.120 of the JSE Derivative Rules states that the JSE shall have the power to “establish and maintain, to the satisfaction of the Registrar, a Fidelity Fund out of which shall be paid claims up to an amount specified in the rules of such fund in respect of liabilities arising prior to the default of a member.”
\item The JSE trustees are defined in footnote 275 above.
\item See s 1.120 of the JSE Derivative Rules.
\end{itemize}
\end{footnotesize}
2.8 CONCLUSION

This Chapter provided an overview of selected terminology, the regulators and the current legal framework pertaining to the segments of the financial market selected for the purposes of this dissertation. These segments included the capital market, the money market and the derivative market. A discussion of the commodity market was included in the segment dealing with the derivative market.

The Chapter commenced with the financial market terminology selected. The selection of the terms was based on a diagram illustrating an overview of the roleplayers and financial instruments in the financial market. The selected terminology included the terms securities, issuer, certificated securities, uncertificated securities, central securities depository, central securities depository participant, unlisted securities, listed securities, exchange, authorised user, securities services, regulated person, self-regulatory organisation and client.

This was followed by the overview of the establishments and organisational structures of the respective regulators operating in the financial market. The discussion on the regulators included: the SARB, FSB, Strate and JSE. The overview also included a discussion on the recent consolidation of the JSE and BESA.

Succeeding this was an overview of the current legal framework pertaining to the financial market which was based on a diagram illustrating an overview of the legislative foundation of the financial market. The legislative measures discussed included the SSA, the SARB Act, the NPS Act, the Banks Act, the Companies Act as well as the FSB Act. An overview of the various international institutions providing international best practice, to which South African is a member, followed. These institutions included IOSCO, G20, IMF, World Bank, UNIDROIT, Financial Stability Board and the BIS.

Finally, a discussion on the specific legal frameworks pertaining to the selected segments of financial market followed. The first segment was the capital market. The capital market was defined as “a complex of institutions and mechanisms through
which funds with terms of more than three years are pooled and made available to the private and public sectors.” The discussion on the legal framework pertaining to the capital market included the SSA, the CSD Rules and Directives, the Exchange Rules, the Exchange Directives, the Exchange Listing Requirements and the Exchange Guarantee Fund Rules.

The second segment was the money market. The money market was defined as the market where short-term securities are traded. The specific money market instruments defined and discussed included bankers’ acceptances, promissory notes, treasury bills, negotiable certificate of deposits, South African Reserve Bank debentures, Land Bank bills, commercial paper, repurchase agreements, bridging bonds, capital project bills, Transnet Limited coupon stocks and call bonds. The discussion on the legal framework pertaining to the money market included the latest developments in the money, Chapter IV of the Securities Services Act, the CSD Rules and Directives and the South African Reserve Bank Operational Notice.

The last segment was the derivative market. The derivative market was defined as the market for derivative instruments. A derivative instrument was defined as “any financial instrument or contract that creates rights and obligations and that derives its value from the price or value, or the value of which may vary depending on a change in the price or value, of some other particular product or thing.” The specific derivative instruments defined and discussed included Futures and Forwards, Swaps, Options and Warrants. The discussion on the legal framework pertaining to the derivative market included the following: the Securities Services Act, CSD Rules and Directives, the Exchange Rules, the Exchange Directives and the JSE Ltd Fidelity Fund Rules.
CHAPTER THREE
SECURITIES SETTLEMENT IN SOUTH AFRICA

3 1 INTRODUCTION

The settlement of uncertificated securities by a CSD is one of the most crucial components of an effective financial market. Securities settlement in South Africa has recently been affected by the promulgation of the Companies Act, 2008.\(^{365}\)

This Chapter aims to give an overview of the securities settlement process in South Africa. It also aims to examine the impact of the Companies Act, 2008 on securities settlement. Such examination is necessitated by the need for companies, holders of uncertificated securities and holders of beneficial interests in uncertificated securities, to become conscious of their rights and obligations as affected by the promulgation of the Companies Act, 2008. The differences highlighted through this examination can also be used as a guideline by companies in amending their regulatory frameworks so as to ensure full compliance with the Companies Act, 2008.

3 2 THE SECURITIES SETTLEMENT PROCESS IN SOUTH AFRICA

As noted above,\(^{366}\) the settlement of equities, bonds and money market instruments are performed, regulated and supervised by Strate. The term “settlement” refers to the “completion of a transaction, whereby securities and corresponding cash are delivered and received.”\(^{367}\) In terms of the Companies Act, 1973 and 2008\(^{368}\) the

\(^{365}\) As discussed in paragraph 2 4 6 above. The Companies Act, 2008 will be discussed in conjunction with the Companies Amendment Bill, 2010 and any references to Companies Act, 2008 should be deemed to include the amendments as posed by the Companies Amendment Bill.

\(^{366}\) See paragraph 2 3 4 above.


\(^{368}\) S 91A(4) and s 140A of the Companies Act, 1973 and its corresponding provisions in s 53 and s 56 of the Companies Act, 2008. These sections are respectively discussed in paragraphs 3 3 2 1 and 3 3 3 below.
transfer of securities which take place on settlement is a transfer of ownership or beneficial interest pertaining to uncertificated securities.\footnote{369}{In terms of s 2 of the Companies Amendment Bill, 2010 the term “securities” is defined as “(a) any share issued, or authorised to be issued, by a profit company; or (b) anything falling within the meaning of “securities” asset out in section 1 of the Securities Services Act, 2004 (Act No. 36 of 2004) and includes shares held in a private company.” For a definition of “private company” see footnote 451 below.}

In the settlement environment, Strate utilises the principle of “rolling settlement.” “Rolling settlement” entails that uncertificated securities transactions “become due for settlement a set number of business days after trade.”\footnote{370}{Strate Limited “Benefits of Strate” http://www.strate.co.za/aboutstrate/overview/benefits%20of%20strate.aspx (accessed 10-10-2010).} Where “T” refers to Trade Date, equities settle T+5.\footnote{371}{Five days after trade.} Bonds settle T+3\footnote{372}{Three days after trade. This is referred to as standard trades or spot trades.} and are also allowed to settle in less than 3 days\footnote{373}{This is referred to as non-standard trades.} or T+0 (referred to as same day settlement).\footnote{374}{Strate Limited Bonds Handbook Version 2.0 (2006) 66 and Strate Limited “Benefits of Strate” http://www.strate.co.za/aboutstrate/overview/benefits%20of%20strate.aspx (accessed 10-10-2010).} As noted above,\footnote{375}{See paragraph 2 3 4 above.} Strate recently added the settlement of money market instruments to its portfolio of services and these instruments settle T+0.\footnote{376}{Strate Limited “Benefits of Strate” http://www.strate.co.za/aboutstrate/overview/benefits%20of%20strate.aspx (accessed 10-10-2010).}

Strate not only caters for the settlement of trades concluded on an exchange,\footnote{377}{This type of settlement is referred to as “on-market settlement” in respect of equities and “on-exchange trades” in respect of bonds. As money market instruments are traded OTC, no distinction applies. See paragraph 2 6 2 1 above.} but for OTC trades as well.\footnote{378}{Referred to as “off-market settlement” in respect of equities and “off-exchange trades” in respect of bonds. For an explanation of the OTC market, see paragraph 2 5 1 above.} The settlement process of an on-market settlement commences with a JSE broker who enters the order into TradElect.\footnote{379}{TradElect is discussed in paragraph 2 3 5 2 above.} In TradElect the order is matched automatically with an opposite order. This matched trade is then passed from TradElect to the processing system of Strate, the Southern African Financial Instruments Real Time Electronic Settlement System.\footnote{380}{Southern African Financial Instruments Real Time Electronic Settlement (hereinafter “SAFIRES”). SAFIRES is the electronic settlement system used by Strate which caters for the issuance, custody, clearing and settlement of securities. It also serves as the depository system for Strate.}
sends an instruction to a CSD Participant to settle. In the event of an off-market settlement a trade is simply reported to a CSD Participant. The relevant CSD Participant responds by “committing” its intention to settle to Strate and accordingly, SAFIRES is informed that settlement may proceed.\textsuperscript{381}

“Commitment” can be described as:

“An electronic instruction that constitutes an undertaking by a Participant to settle a transaction in uncertificated Securities on Settlement Date.”\textsuperscript{382}

In terms of the JSE Rules and Directives as well as the CSD Directives, commitment by a CSD Participant is a prerequisite for on-exchange and OTC equities trades.\textsuperscript{383} Such commitment must take place on T+3. This prerequisite also applies to bonds traded in terms of the BESA Rules.\textsuperscript{384} According to the BESA and CSD Directives, commitment must place take one day before settlement\textsuperscript{385} or on settlement day.\textsuperscript{386} As money market instruments settle T+0, commitment takes place on settlement day.\textsuperscript{387}

On settlement day, SAFIRES confirms the availability of securities at CSD Participant level through a process known as the “reservations process.”\textsuperscript{388} If such reservation is successful, SAFIRES proceeds to send a request to the SARB for the transfer of cash between the relevant CSD Participants through the SARB settlement system.\textsuperscript{389}

\textsuperscript{381} Strate Limited “Equities Settlement Services” http://www.strate.co.za/products%20services/clearing%20settlement%20services/equities%20settlement%20services.aspx (accessed 09-10-2010).
\textsuperscript{382} It should be noted that “commitment” by a Participant may be reversed under exceptional circumstances, e.g. a sequestration event, in terms of the CSD Directive SCB.
\textsuperscript{383} JSE Rule 13.60.1.4, JSE Equities Directives E, s EF and CSD Directives SCC, s 3.3.1.2 and SCV, s 3.7.
\textsuperscript{384} The BESA Rule D.7.1.3.
\textsuperscript{385} In respect of OTC bond trades. See CSD Directive SFA s 2.2.1.
\textsuperscript{386} In respect of on-exchange bonds. See BESA Directive D7.1, Article 2.
\textsuperscript{387} CSD Directive SGA s 3.3.
\textsuperscript{389} The SARB settlement system (SAMOS) is defined in s 1 of the NPS Act. The Act defines a “settlement system” as a “system established and operated by the South African Reserve Bank for the discharge of payment and settlement obligations between system participants.” In terms of s 1 of the NPS Act a “system participant” refers to a member of the payment system management body.
These cash obligations are subsequently netted across transactions, per CSD Participant, per payment run.

Once the availability of cash has been confirmed by the SARB and has subsequently been transferred between the SARB bank accounts at CSD Participant level through SAMOS, SAFIRES transfers ownership within a CSD Participant’s uncertificated securities accounts in the SAFIRES system in accordance with the Companies Act. Accordingly, the SARB provides for final and irrevocable “payment” settlement (therefore, the “payment leg” of securities settlement) through SAMOS and Strate provides for real-time settlement and finality of “ownership” transfer through SAFIRES (the “securities leg” of securities settlement). Confirmation of a successful settlement is then related to the CSD Participant, who reflects the entry in its books at client level.

### 3.3 THE IMPACT OF THE COMPANIES ACT 71 OF 2008 ON SETTLEMENT

#### 3.3.1 Introduction

What follows below is a comparison between the Companies Act, 1973 and the Companies Act, 2008 relating to the provisions regulating registration and transfer of uncertificated securities. The relevant sections in the Companies Act, 1973 are sections 91A and 140A and the corresponding sections in the Companies Act, 2008 are to be found in sections 49 to 56 (Part E).

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390 According to Strate, “netting” refers to a “process of summing trades to arrive at a nett settlement position. This means settlement of cash or securities balances by summing all credits and countervailing debits for a given day or session, then moving cash or securities only in the amount of the nett total.” See Strate Limited “Glossary” [http://www.strate.co.za/glossary.aspx](http://www.strate.co.za/glossary.aspx) (accessed 10-10-2010).


392 In terms of s 29 of the SSA a Participant securities account refers to “an account kept by or on behalf of a participant for a client and reflecting the number or nominal value of securities of each kind deposited and all entries made in respect of such securities.” See footnote 368 above and paragraphs 3321 and 333 below.


3.3.2 Uncertificated Securities

Section 91A of the Companies Act, 1973 commence with five definitions namely, “CSD”, “certificated securities”, “Participant”, “subregister”, and “uncertificated securities.” The definitions contained in 91A are not to be found in the corresponding sections of the Companies Act, 2008, but in Chapter 1 of the Act, in the Interpretation Section under “Definitions.”

A comparison between these definitions, as contained in the respective Acts, reveals the following. Firstly, the meaning of the terms “CSD” and “Participant” correspond precisely. Secondly, both Acts denote to the term “uncertificated securities” the meaning as set out in the SSA. However, in addition, the definition in the Companies Act, 1973 states that such uncertificated securities are entered into the company’s register of members. The Companies Act, 2008 does not refer to a company’s register of members, but to a company’s securities register. Accordingly, all references to a company’s register of members in terms of the Companies Act, 1973 will be substituted with references to a company’s securities register. Thirdly, unlike the Companies Act, 1973 which defines “certificated securities” with reference to the SSA, the Companies Act, 2008 contains no such reference. It merely states that for purposes of the Act, “certificated” means “evidenced by a certificate.”

Finally, the Companies Act, 2008 does not utilise the term “subregister”, but the term “uncertificated securities register.” An uncertificated securities register is defined in the Companies Act, 2008 as:

These terms have been discussed in paragraph 2.2 above. S 49 to 56 of the Companies Act, 2008. Both Acts denote to these terms their respective meanings as set out in s 1 of the SSA. S 29 of the SSA. In terms section 2 of the Companies Amendment Bill, 2010 a “securities register” is defined as “the register required to be established by a profit company in terms of section 50(1).” See paragraph 3.3.2.2 below. For a definition of “profit company”, see footnote 449 below. S 29 of the SSA. S 49(1) of the Companies Act, 2008. In terms of the s 91A (1) (c) of the Companies Act, 1973, a subregister means the “record of uncertificated securities administered and maintained by a participant , which forms part of the relevant company’s register of members as referred to in this Act.”
“The record of uncertificated securities administered and maintained by a participant or central securities depository, as determined in accordance with the rules of a central securities depository, and which forms part of the relevant company’s securities register established and maintained in terms of Part E of Chapter 2.”

Accordingly, all references to a subregister in terms of the Companies Act, 1973 will be substituted with references to an uncertificated securities register. According to the above definition, this uncertificated securities register will form part of the companies securities register. It should be noted that the SSA currently makes reference to and defines a subregister in terms of section 91A(1) of the Companies Act, 1973 and accordingly, this definition will have to be amended to reflect the term “uncertificated securities register” and its attributed definition in the Companies Act, 2008.

Section 91A(2)(a) states that section 91A shall apply to uncertificated securities, notwithstanding any provision to the contrary contained in the Companies Act, 1973 or in any other law, the common law, an agreement or any articles. The corresponding section in the Companies Act, 2008 is section 49(4), which provides that sections 52 to 55 applies only to uncertificated securities and these sections prevail in the case of a conflict between any provision of those sections and any other provision of this Act, any other law, the common law, the company’s Memorandum of Incorporation or any agreement. It is evident that no

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404 S 1 of the Companies Act, 2008.
405 It is submitted that this new term and its corresponding definition is much broader and has the potential to, in the future, accommodate a different model of securities settlement.
406 S 29 of the SSA.
407 These sections respectively regulate the registration and transfer of uncertificated securities, substitution of certificated securities for uncertificated securities and liability relating to uncertificated securities.
408 This document that will replace the memorandum and articles of association when the Companies Act, 2008 comes into force. S 2 of the Companies Amendment Bill, 2010 defines the Memorandum of Incorporation as

"the document, as amended from time to time, that sets out rights, duties and responsibilities of shareholders, directors and others within and in relation to a 10 company, and other matters as contemplated in section 15, and by which—
(a) that sets out rights, duties and responsibilities of shareholders, directors and others within and in relation to a company, and other matters as contemplated in section 15, and the company was incorporated in terms of this Act, as contemplated in section 13;
(b) by which a pre-existing company was structured and governed before the later of the -

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significant differences exist between the two corresponding sections and both intend to regulate the transfer and registration of uncertificated securities.

Section 91A(2)(b) provides that, unless otherwise provided by the Act, the Act applies in the same manner to certificated securities as to uncertificated securities. The corresponding section in the Companies Act, 2008 is section 49(3)(b), which provides the same.

3321 Transfer of Uncertificated Securities

Sections 91A(4), 91A(5) and 91A(6) of the Companies Act, 1973 deal with the transfer of uncertificated securities. This type of transfer referred to is the transfer of ownership of uncertificated securities from one subregister to another. The corresponding section in the Companies Act, 2008 is section 53 which states the following:

“(1) The transfer of uncertificated securities in an uncertificated securities register may be effected only –

(a) by a participant or central securities depository;
(b) on receipt of -
   (i) an instruction to transfer sent and properly authenticated in terms of the rules of a central securities depository; or
   (ii) an order of a court; and
(c) in accordance with this section and the rules of the central securities depository.

(2) Transfer of ownership in any uncertificated securities must be effected by -

(a) debiting the account in the uncertificated securities register from which the transfer is effected; and

(i) the effective date; or
(ii) the date it was converted to a company in terms of Schedule 2; or a pre-existing company was structured and governed before the later of the –
   (aa) the effective date; or
   (bb) the date it was converted to a company in terms of Schedule 2;
(c) a domesticated company is structured and governed;”

It should be noted on an interpretation of the Companies Act, 2008 it seems that the common law prevails in a conflict between the Companies Act, 2008 and the common law in the case of certificated securities. See Du Plessis, R “Should different rules apply to the transfer of ownership in certificated and uncertificated securities” http://www.bowman.co.za/LawArticles/Law-Article.asp?id=2132417139 (accessed 12-10-2010).
(b) crediting the account in the uncertificated securities register to which the transfer is effected, in accordance with the rules of a central securities depository.

(3) The requirements of section 51(5), read with the changes required by the context, apply with respect to a transfer of uncertificated securities.

(4) A transfer of ownership in accordance with this section occurs despite any fraud, illegality or insolvency that may –

(a) affect the relevant uncertificated securities; or

(b) have resulted in the transfer being effected, but a transferee who was a party to or had knowledge of the fraud or illegality, or had knowledge of the insolvency, as the case may be, may not rely on this subsection.

(5) A court may not order the name of a transferee contemplated in this section to be removed from an uncertificated securities register, unless that person was a party to or had knowledge of a fraud or illegality as contemplated in subsection (4).

(6) Nothing in this section prejudices any power of a participant or central securities depository, as the case may be, to effect a transfer to a person to whom the right to any uncertificated securities of a company has been transmitted by operation of law.” (my underlining)

In summary, section 53 provides that the transfer of ownership of uncertificated securities may only be affected by a CSD or CSD Participant and such transfer is to be effected by the debiting and crediting of the respective securities accounts concerned, in accordance with the CSD Rules. This transfer of ownership occurs despite any fraud, illegality or insolvency. It should be noted that the ground of insolvency was not contained in the Companies Act, 1973 and accordingly, in future settlement of securities will take place despite insolvency. It is submitted that this ground has been inserted to protect bona fide purchasers of securities.

A comparison between sections 91A(4), 91A(5) and 91A(6) of the Companies Act, 1973 and section 53 of the Companies Act, 2008 reveals the following. Firstly, unlike section 91A(5), section 53 includes the role and the rules of a CSD in conjunction with the role of a CSD Participant. Secondly, section 53(3) was not contained in the Companies Act, 1973 and is, therefore, additional to the Companies Act, 2008. This

410 It should also be noted that the SSA does not address issues, such as finality, in the case of insolvency of a CSD Participant.
section provides that section 51(5)\(^{411}\) applies to the transfer of ownership of uncertificated securities. Section 51(5) sets out the details a company must enter into its securities register concerning every transfer of uncertificated securities.\(^{412}\)

Finally, sections 91A(4)(b),\(^{413}\) 91A(4)(d),\(^{414}\) 91A(4)(e)\(^{415}\) and section 91A(6)\(^{416}\) of the Companies Act, 1973 were not included in the Companies Act, 2008.

3322 Disclosures Relating to Uncertificated Securities

Section 91A(3) of the Companies Act, 1973 deals with disclosures relating to uncertificated securities. The corresponding sections in the Companies Act, 2008 are sections 50 and 52. These sections state the following:

Section 50:

(1) “Every company must -

(a) establish or cause to be established a register of its issued securities in the prescribed form; and
(b) maintain its securities register in accordance with the prescribed standards.

(2) As soon as practicable after issuing any securities a company must enter or cause to be entered in its securities register, in respect of every class of securities that it has issued –

(a) the total number of those securities that are held in uncertificated form;
(b) with respect to certificated securities—

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\(^{411}\) Of the Companies Act, 2008.

\(^{412}\) S 51(5) provides that the following details must be included in the company’s securities register upon the transfer of uncertificated securities:

“a company must enter in its securities register every transfer of any certificated securities, including in the entry -

(a) the name and address of the transferee;
(b) the description of the securities, or interest transferred;
(c) the date of the transfer; and
(d) the value of any consideration still to be received by the company on each share or interest, in the case of a transfer of securities contemplated in s 40(5) and s (6).”

\(^{413}\) S 91A(4)(b) provides that a transferee whose name was entered into a company’s subregister becomes a member of the company.

\(^{414}\) S 91A(4)(d) excludes s 133 from the transfer of uncertificated securities. S 133 deals with the registration and transfer of shares or interests. It provides that any transfer of share of or interest in a company shall be entered into its register of members.

\(^{415}\) S 91A(4)(e) denotes to companies the liability of payment of a fee to participants for the transfer of uncertificated securities.

\(^{416}\) S 91A(6) provides that s 114 (dealing with the power to close register of members) shall not apply to a subregister.
(i) the names and addresses of the persons to whom the securities were issued;
(ii) the number of securities issued to each of them;
(iii) the number of, and prescribed circumstances relating to, any securities—
   (aa) that have been placed in trust as contemplated in section 40(6)(d); or
   (bb) whose transfer has been restricted;
(iv) in the case of securities contemplated in section 43—
   (aa) the number of those securities issued and outstanding; and
   (bb) the names and addresses of the registered owner of the security and any holders of a beneficial interest in the security; and
(v) any other prescribed information.

(3) If a company has issued uncertificated securities, or has issued securities that have ceased to be certificated, as contemplated in section 49(5), a record must be administered and maintained by a participant or central securities depository in the prescribed form, as the company’s uncertificated securities register, which—

   (a) forms part of that company’s securities register; and

   (b) must contain, with respect to all securities contemplated in this subsection, any details—
      (i) referred to in subsection (2)(b), read with the changes required by the context; or
      (ii) determined by the rules of the central securities depository.

(4) A securities register, or an uncertificated securities register, maintained in accordance with this Act is sufficient proof of the facts recorded in it, in the absence of evidence to the contrary.

(5) Unless all the shares of a company rank equally for all purposes, the company’s shares, or each class of shares, and any other securities, must be distinguished by an appropriate numbering system.”

Section 52:

(1) “At the request of a company, and on payment of the prescribed fee, if any, a participant or central securities depository, as determined in accordance with the rules of the central securities depository, must furnish that company with all details of that company’s uncertificated securities reflected in the uncertificated securities register.

(2) A person who wishes to inspect an uncertificated securities register may do so only—

   (a) through the relevant company in terms of section 26; and
   (b) in accordance with the rules of the central securities depository.

(3) Within five business days after the date of a request for inspection, a company must produce a record of the uncertificated securities register, which record must reflect at least the details referred to in section 50(3)(b)
at the close of business on the day on which the request for inspection was made.

(4) A participant or central securities depository, determined in accordance with the rules of the central securities depository –

(a) must provide a regular statement at prescribed intervals to each person for whom any uncertificated securities are held in an uncertificated securities register, setting out the number and identity of the uncertificated securities held on that person’s behalf;

(b) must not impose a charge for a statement on the person entitled to the statement; and

(c) may impose a charge or service fee for such a statement on the relevant company in accordance with the regulations.

(5) The regulations contemplated in section 49(7) may provide for a charge or service fee for statements contemplated in subsection (4) (c).” (my underlining)

In summary, sections 50 and 52 of the Companies Act, 2008 requires companies and CSD’s/CSD Participants to record and maintain specific details pertaining to uncertificated securities in their respective securities registers and sets out the requirements for the inspection of such registers.

A comparison between section 91A(3) and sections 50 and 52 reveals the following. Firstly, the provisions in section 50(3)(b)(ii) and section 52(2)(b) were not previously contained in the Companies Act, 1973 and is, therefore, additional to the Companies Act, 2008. Section 50(3)(b)(ii) provides that the CSD Rules may also prescribe certain details which must be contained in the securities register to be established and maintained by a CSD Participant or a CSD in respect of the uncertificated securities held by them. Section 52(2)(b) provides that the inspection of uncertificated securities registers must be done, not only in accordance with the Companies Act, but with the CSD Rules as well.

Secondly, sections 50(4) and 50(5) are also additional to the Companies Act, 2008. Section 50(4) provides that a securities register or an uncertificated securities register, maintained in accordance with the Companies Act, 2008, is sufficient proof of the facts recorded in it in the absence of evidence to the contrary. Section 50(5) provides that “[u]nless all the shares of a company rank equally for all purposes, the company’s shares, or each class of shares, and any other securities, must be distinguished by an appropriate numbering system.”
Thirdly, section 52(3) allows “five business days” from the date of request within which to produce the uncertificated securities register (obtained from the CSD or CSD Participant) for inspection. Section 91A(e)(ii) allows “seven days.” The difference between “business days” and “days” lies in the method of computation of time periods. When reference it made to “business days”, the first day is excluded, as well as Saturdays, Sundays and public holidays. The last day is included.\footnote{In terms of s 1 and s 5(3) of the Companies Act, 2008. Also see Pete, Hulme, Du Plessis & Palmer Civil Procedure: A Practical Guide (2008) 105 & 106.} However, when reference is made to “days”, it includes all the normal calendar days (which include Saturdays and Sundays and public holidays).

Finally, there is no corresponding section in the Companies Act, 2008 to the provision in section 91A(3)(b), which provides that “no name of any person for whom a participant holds uncertificated securities as nominee shall form part of the subregister.” Hence, it can be concluded that, in the future, the names of such nominees will be included for the purposes of the securities register of a company. It should be noted that sections 36(1) and 36(2) of the draft Regulations set out the specific details which must be contained in the securities register of a profit company as required in terms of section 50(2)(b).\footnote{See paragraph 3 3 2 5 below.}

\textbf{3 3 2 3 Substitution of Uncertificated Securities for Certificated Securities}

As a starting point it should be noted that section 91A(10) of the Companies Act, 1973, which provides an offeree with a choice between certificated or uncertificated securities at such time that the securities are offered to him/her by the company concerned, is not included in the Companies Act, 2008.\footnote{S 91A(10) of the Companies Act, 1973 provides the following:  
\textit{(a)} Subject to subparagraph (b), when any new offer of securities is made by a company, the offeree may elect whether all or any part of the securities offered to him, her or it must be issued in certificated or uncertificated form.  
\textit{(b)} A company shall only issue or allot uncertificated securities to a person who is already a client of a participant or for whom a participant has agreed to act.}
Section 91A(7) of the Companies Act, 1973 regulates the substitution of uncertificated securities for certificated securities. The corresponding section in the Companies Act, 2008 is section 54 which provides the following:

1. “A person who wishes to withdraw all or part of the uncertificated securities held by that person in an uncertificated securities register, and obtain a certificate in respect of those withdrawn securities, may so notify the relevant participant or central securities depository, as determined in accordance with the rules of the central securities depository, which must within five business days –

   (a) notify the relevant company to provide the requested certificate; and
   (b) remove the details of the uncertificated securities from the uncertificated securities register.

2. After receiving a notice in terms of subsection (1)(a) from a participant or central securities depository, as the case may be, a company must -

   (a) immediately enter the relevant person’s name and details of that person’s holding of securities in the company’s securities register and indicate on the register that the securities so withdrawn are no longer held in uncertificated form; and
   (b) within 10 business days, or 20 business days in the case of a holder of securities who is not resident within the Republic –
      (i) prepare and deliver to the relevant person a certificate in respect of the securities; and
      (ii) notify the central securities depository that the securities are no longer held in uncertificated form.

3. A company may charge a holder of its securities a reasonable fee to cover the actual costs of issuing a certificate, as contemplated in this section."

In summary, section 54 caters for the event where a person wishes to substitute his/her uncertificated securities for certificated securities. Such a person must notify the relevant CSD Participant or CSD who must, in turn, remove the uncertificated securities details from its uncertificated securities register and notify the relevant company. The company then enters the amendments into its securities register.

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420 This process is also referred to as “rematerialisation.” Rematerialisation means the physical withdrawal of previously dematerialised securities held at a CSD.

421 The substitution of certificated securities for uncertificated securities (and vice versa) by the CSD is regulated by the CSD Rule 6.2.1-6.2.3 and the CSD Directives SBA (Dematerialisation and Rematerialisation Business Model – Equities) and SBB (Procedures for Conversion of Certificated Bonds to Uncertificated Bonds and vice versa). Due to the fact that the existing money market instruments were not be dematerialised, no corresponding Directive for money market instruments has been published by Strate. Also see paragraph 2 6 2 2 above.
A comparison between section 91A(7) and section 54 reveals the following. Firstly, unlike section 91A(7) of the Companies Act, 1973, section 54 includes the role and the rules of a CSD in conjunction with the role of a CSD Participant. Secondly, section 91A(7)(b)(i) of the Companies Act, 1973 provides for seven days to a CSD Participant or CSD, after the receipt of a notice to convert certificated securities into uncertificated securities, to notify the relevant company and remove such details from its uncertificated securities register. The corresponding section in 54(1) of the Companies Act, 2008 provides for five business days.\textsuperscript{422} Thirdly, section 91A(7)(b)(iii) provides a company with 14 days within which to prepare the securities certificate and to notify the CSD that the securities are no longer held in certificated form. The corresponding section in section 54(2)(b) provides for 10 business days.\textsuperscript{423} In the fourth instance, section 54(2)(b) grants companies “20 business days in the case of holders of securities not resident within the Republic” to comply with section 54(2)(b). These 20 additional business days provided to non-residents of the Republic were not previously provided for in the Companies Act, 1973 and are, therefore, additional to the Companies Act, 2008. In the fifth instance, section 54(3) which entitles a company to elect to charge a fee to the holder of the securities who converts their securities from certificated to uncertificated form is also additional to the Companies Act, 2008. Finally, its evident that section 91A(7)(b)(iv)\textsuperscript{424} was not included in the Companies Act, 2008.

\textbf{3 3 2 4 Liability Relating to Uncertificated Securities}

Sections 91A(8), 91A(9) and 91A(12) deal with the liabilities relating to uncertificated securities. The corresponding section to section 91(8) in the Companies Act, 2008 is section 55(1) which states the following:

\footnote{422}{This difference is discussed in paragraph 3 3 2 2 above.}
\footnote{423}{Ibid.}
\footnote{424}{This section provides that “transfer of ownership or acquisition of membership in respect of uncertificated securities that has been substituted for certificated securities shall not be capable of being effected through a CSD while they remain in certificated form.” One of the reasons why the legislature elected to exclude this provision might be due to the fact that one of the common characteristics of uncertificated securities is it can only be transacted through a CSD.}
“A person who takes any unlawful action in consequence of which any of the following events occur in a securities register or uncertificated securities register, namely –

(a) the name of any person remains in, is entered in, or is removed or omitted;
(b) the number of uncertificated securities is increased, reduced, or remains unaltered; or
(c) the description of any uncertificated securities is changed, is liable to any person who has suffered any direct loss or damage arising out of that action.”

A comparison between sections 55(1) and 91A (8) reveals that these two sections correspond exactly.

The corresponding sections to section 91A(9) in the Companies Act, 2008 are sections 55(2) and 55(3) which provide the following:

(2) “A person who gives an instruction to transfer uncertificated securities must –

(a) warrant the legality and correctness of that instruction; and
(b) indemnify the company and the participant or central securities depository required to effect the transfer in accordance with the rules of the central securities depository, against any claim and against any direct loss or damage suffered by them arising out of such a transfer by virtue of an instruction referred to in this subsection.

(3) A participant or central securities depository who may effect the transfer of uncertificated securities in accordance with the rules of a central securities depository must indemnify –

(a) a company against any claim made upon it and against any direct loss or damage suffered by it arising out of a transfer of any uncertificated securities; and
(b) any other person against any direct loss or damage arising out of a transfer of any uncertificated securities, if that transfer was effected by the participant or central securities depository without instruction, or in accordance with an instruction that was not sent and properly authenticated in terms of the rules of a central securities depository, or in a manner inconsistent with an instruction that was sent and properly authenticated in terms of the rules of a central securities depository.” (my underlining)

A comparison between section 91A(9) and sections 55(3) and 55(2) reveals that sections 55(2) and 55(3) include the role and rules of a CSD in conjunction with the role of a CSD Participant. It also reveals that two additional grounds for liability is provided for in section 55(3)(b), which provides that a CSD Participant or CSD may
be held liable to indemnify any other person who suffers any direct loss or damage as a result of the transfer of uncertificated securities in accordance with an instruction that was not sent and properly authenticated or a manner inconsistent with an instruction that was sent and properly authenticated in terms of the CSD Rules.

Section 91A(12)\textsuperscript{425} sets out the offences and related liabilities which arise from the contraventions specified in sections 91A(5)(a)\textsuperscript{426} and 91A(8). A comparison between the Companies Act, 1973 and the Companies Act, 2008 reveals that no corresponding section is to be found in the Companies Act, 2008. Chapter 9 of the Companies Act, 2008 which deals with offences and penalties also makes no specific reference to offences and liabilities arising from the registration and transfer of uncertificated securities.

\textbf{3 3 2 5 Uncertificated Securities Regulations}

Section 91A(11) empowers a Minister to make regulations regarding matters that are supplementary and ancillary to the sections of the Act dealing with securities registration and transfer. In terms of section 91A(11) of the Companies Act, 1973, the Minister of Trade and Industry published regulations pertaining to uncertificated securities, namely, the Uncertificated Securities Regulations, 1999.\textsuperscript{427} These Regulations deal with the following:

\begin{center}
\textbf{\textsuperscript{425}S 91A(12) provides the following:}
"Any person –
(a) other than a participant, who effects the transfer of uncertificated securities in contravention of subsection (5)(a);
(b) who takes any unlawful action contemplated in subsection (8); or
(c) who, without proper authority, accesses any computer system or record maintained by a participant or a central securities depository, shall be guilty of an offence and liable on conviction to a fine not exceeding R500 000 or to imprisonment for a period not exceeding two years or to both such fine and such imprisonment."
\textsuperscript{426}S 91A (5)(a) states that only a Participant may effect the transfer of uncertificated securities. The corresponding section is s 53 (1) of the Companies Act, 2008 and is set out in paragraph 3 3 2 1 above.
\textsuperscript{427}Hereinafter “the Regulations.”
\end{center}
• the instruction, which had to be given by the holder of securities whose name is entered into the companies register of members, to convert certificated securities into uncertificated securities;\textsuperscript{428}

• the duties of a company following an instruction to convert certificated securities into uncertificated securities;\textsuperscript{429}

• the duties of a company after it has accepted an instruction to convert certificated securities into uncertificated securities;\textsuperscript{430} and

• the duties of a company after such a conversion.\textsuperscript{431}

\textsuperscript{428} This is provided for in s 2 of the Regulations which provides:
“(1) An instruction to a company to convert certificated securities into uncertificated securities must be given by the holder of the certificated securities whose name is entered in the company’s register of members as the holder of the certificated securities in question, or by his or her authorised agent.

(2) A person who lodges certificated securities with a company, accompanied by an instruction referred to in subregulation (1), must do so in the manner and form prescribed in the rules of the central securities depository and must, in particular-
(a) provide complete and accurate information about the securities to be converted;
(b) indicate clearly on the face of every document of title relating to the certificated securities that such securities are lodged for conversion into uncertificated securities.”

\textsuperscript{429} This is provided for in s 3(1) of the Regulations which provides:
“(1) A company which has been instructed to convert certificated securities into uncertificated securities-
(a) must ensure that the documents and instruction lodged with it, comply with the rules of the central securities depository;
(b) must ensure that the documents of title and other information relating to the certificated securities correspond to the particulars contained in the register of members;
(c) must ensure that-
(i) the distinguishing number recorded in terms of section 95 of the Act is valid;
(ii) the distinguishing number represents the document of title evidencing the entitlement of the person who has given the instruction to convert;
(iii) a document of title relating to the certificated securities is valid and has not been cancelled or recorded by the company as lost or stolen;
(iv) the number of certificated securities to which a document of title relates does not exceed the holding allocated to the member concerned in the register of members;
(d) must verify that the document of title relating to the certificated securities has, on the face of it, been validly issued by the company;
(e) may not act on an instruction to convert if it has reason to doubt the validity of the instruction or the document of title relating to the certificated securities.”

\textsuperscript{430} This is provided for in s 3(2) of the Regulations which provides:
“(2) A company must, after it has accepted an instruction to convert certificated securities into uncertificated securities-
(a) record in the register of members the date on which the securities are converted;
(b) indicate clearly on the face of the document of title relating to the securities that the securities have been converted;
(c) reflect the converted securities as uncertificated securities in its register of members.”
The equivalent to section 91A(11) is contained in section 49(7) of the Companies Act, 2008 and provides the same. As noted above, the Draft Regulations to the Companies Act, 2008 has recently been published. Except for the new terminology introduced by the Companies Act, 2008 and a few additional provisions, the regulations published in terms of the Companies Act, 1973 is similarly contained in the Draft Regulations.

The noted additions to the Draft Regulations deal with (a) the details which must be contained in the securities register of a profit company as required in terms of section 50(2)(b); (b) the details which must be entered into a company’s securities register

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431 This is provided for in s 3(3) and 3(4) of the Regulations which provides:

“(3) A company must, after certificated securities have been converted in terms of subregulation (2), instruct the participant appointed by the member, or in the absence of such a participant, a participant appointed by the company which has agreed with the company to hold the securities on behalf of the member, to enter in a subregister the number of uncertificated securities and the name of the member as it appeared in the company’s register of members before the conversion took place.

(4) Except in accordance with section 91A(7) of the Act or a court order, a company may not require a participant to remove or change the particulars of uncertificated securities from or in a subregister and a company may not reduce the balance of uncertificated securities recorded in its register of members.”

432 See paragraph 246 and footnote 180 above.

433 Such as an “uncertificated securities register” as opposed to a “subregister.”

434 S 2 is contained in s 38 of the draft Regulations and s 3 is contained in s 39 of the Draft Regulations.

435 S 36(1) and s 36(2) of the draft Regulations provide the following:

“(1) The securities register of a profit company required in terms of section 24 (4)(a), read with section 50 (2)(b), must be kept in one of the official languages of the Republic, and must comprise -

(a) for every class of authorized securities, a record of -
   (i) the number of securities authorized, and the date of authorization;
   (ii) the total number of securities of that class that have been issued, reacquired or surrendered to the company; and
   (iii) the number of issued securities of that class that are held in uncertificated form;

(b) in respect of every issuance, re-acquisition or surrender of securities of any particular class, entries showing -
   (i) the date on which the securities were issued, re-acquired or surrendered to the company;
   (ii) the distinguishing number or numbers of any certificated securities issued, re-acquired or surrendered to the company;
   (iii) the consideration for which the securities were issued or re-acquired by, or surrendered to the company; and
   (iv) the name and identity number of the person to, from or by whom the securities were issued, re-acquired or surrendered, as the case may be;

(c) for every class of authorized securities, at any time -
   (i) the number of securities of that class that are available to be issued; and
   (ii) the number of securities of that class that are the subject of options or conversion rights which, if exercised, would require securities of that class to be issued.
on receipt of any disclosures of beneficial interests;\(^{436}\) (c) the manner in which a securities register must be kept;\(^{437}\) (d) the requirements for a company's securities register which is held in electronic form;\(^{438}\) (e) the disposal of entries in a securities

\(^{436}\) In addition to the information otherwise required, the company's securities register must also include -

(a) in respect of each person to whom the company has issued securities, or to whom securities of the company have been transferred -

(i) the person's name and business or residential address, as required by section 50 (2) (b) (i), and the person's email address if available;

(ii) an identifying number that is unique to that person;

(iii) in respect of each issue of securities to that person, the consideration for which the securities were issued, as determined by the company's board in terms of section 40; and

(iv) in respect of each issue or transfer of securities to that person -

(aa) the date on which the securities were issued or transferred to the person;

(bb) the number and class of securities issued or transferred to the person;

(cc) the distinguishing number or numbers of the securities issued or transferred to the person, if the securities are held in certificated form;

(v) the date on which any securities that had been issued or transferred to the person were subsequently -

(aa) transferred by that person, or by operation of law, to another person; or

(bb) re-acquired by, or surrendered to, the company in terms of any provision of the Act or the Memorandum of Incorporation; and

(vi) at any time, the total number of securities of that class held by the person."

Also see paragraph 3 3 2 2 above.

\(^{437}\) S 36(3) and s 36(4) of the Draft Regulations provide the following:

“(3) If a company contemplated in section 56 (7) has received any disclosure of a beneficial interest referred to in that section, the securities register of that company, despite any additional requirements that may be imposed by a central securities depository, must also include -

(a) a record of all such disclosures, including the following information for any securities in respect of which a disclosure was made -

(i) the name and unique identifying number of the registered holder of the securities;

(ii) a reference number to the relevant entry in the company's securities register at which the issue of those securities to the registered holder is recorded;

(iii) the number, class and in the case of certificated securities, the distinguishing numbers of the securities; and

(iv) the name, unique identifying number, business or residential address, and email address if available, of each person who holds a beneficial interest in the securities, and the extent of each such person's interest in the securities.

(4) The requirement of any person to disclose information to a public company in terms of section 56 (4)(a) applies only in respect of a month during which a change has occurred in the information contemplated in section 56 (3), except to the extent that the requirements of a central securities depository provide for more frequent disclosure.”

Also see paragraph 3 3 3 3 below.

\(^{438}\) S 36(5) of the Draft Regulations provides that “[t]he securities register required to be kept by the Act and this regulation must be kept in such a manner as -

(a) to provide indexed access to all relevant entries for anyone person;

(b) to provide adequate precautions against

(i) theft, loss or intentional or accidental damage or destruction; and

(ii) falsification; and

(c) to facilitate the discovery of any falsification.”

S 36(6) of the Draft Regulations provides that “[i]f a company keeps its securities register in electronic form, the company must -
register where a person has ceased to hold securities in the company after seven years; and (f) the acquisition and loss of shareholder rights in securities held by shareholders.

### 333 Beneficial Interests in Securities

Section 140A of the Companies Act, 1973, regulates disclosures of beneficial interests in securities. The corresponding section in the Companies Act, 2008 is section 56. The first amendment contained in the Companies Act, 2008 is section 56(1) which provides that “except to the extent that a company’s Memorandum of Incorporation provides otherwise, the company’s issued securities may be held by, and registered in the name of, one person for the beneficial interest of another person.” Unlike its corresponding provision in the Companies Act 1973, this section provides that a company may state in its Memorandum of Incorporation that securities issued by the company may not be held by one person for the beneficial interests of another. It is submitted that this modification is of great significance as it places a limitation on the scope of beneficial interests in the companies’ environment.

Section 140A commences with three definitions, namely “beneficial interest”, “exchange” and “security” in section 140(A)(1). Similar to section 91A, these definitions are not to be found in the corresponding sections of the Companies Act, 2008, but in Chapter 1 of the Act, in the Interpretation Section under “Definitions.”

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(a) provide adequate precautions against loss of the records as a result of damage to, or failure of, the media on which the records are kept; and
(b) ensure that the records are at all times capable of being retrieved to a readable and printable form, including by converting the records from legacy to later storage media, or software, to the extent necessary from time to time.”

S 36(7) of the Draft Regulations provides that “[a]ny entry in a securities register pertaining to a person who has ceased to hold securities of the company may be disposed of seven years after that person last held any securities of the company.”

S 37 of the Draft Regulations provides that “[a] person -
(a) acquires the rights associated with any particular securities of a company when that person’s name is entered in the company’s securities register as a shareholder to whom those securities have been issued or transferred; and
(b) ceases to have the rights associated with any particular securities of a company when the transfer to another person, re-acquisition by the company, or surrender to the company of those securities has been entered in the company’s securities register.”

It should be noted that the right to hold and denote beneficial interests in securities has been significantly amended.
The term “beneficial interest” is defined as follows:442

“beneficial interest”, when used in relation to a company’s securities, means the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to-

(a) receive or participate in any distribution in respect of the company’s securities;
(b) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company’s securities; or
(c) dispose or direct the disposition of the company’s securities, or any part of a distribution in respect of the securities, but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act No. 45 of 2002).” (my underlining)

When compared to the Companies Act, 1973, it is evident that certain modifications have been made to the definition of “beneficial interest” (as underlined). Firstly, unlike section 140A(1), the definition contained in the Companies Act, 2008443 specifies the ways through which a beneficial interest in a security can be obtained. Secondly, section 140A(1)(a) refers to “the right of entitlement to receive any dividend or interest payable in respect of that security”, whereas section 56(1)(a) refers to the right or entitlement to “receive or participate in any distribution in respect of the company’s securities.” Thirdly, whereas section 140A(1)(b) specifically mentions certain rights, such as voting, conversion and redemption rights, section 56(1)(b) does not mention any specific rights. It merely contains a general provision referring to “any or all of the rights.” In the fourth instance, section 56(1)(c) contains an additional right not included in the Companies Act, 1973, being the right to “dispose or direct the disposition of the company’s securities, or any part of a distribution in respect of the securities...” Lastly, it should be noted that the Companies Act, 1973 makes reference to the now repealed Unit Trusts Control Act444 and accordingly, the Companies Act, 2008 makes reference to its successor, the Collective Investment Schemes Act.445

442 S 1 of the Companies Act, 2008.
443 Ibid.
444 Act 54 of 1981.
Section 140A defines the terms “exchange” and “security” with reference to the now repealed SECA and the FMCA. Section 1 of the Companies Act, 2008\textsuperscript{446} defines both these terms with reference to their meanings as set out in the SSA.\textsuperscript{447} It should specifically be noted that the Companies Act, 2008 not only denotes to the term “securities” the meaning set out in section 1 of the SSA, but in addition also includes the shares held in a private company.\textsuperscript{448} It is clear that that shares held in a private company were specifically included in the definition of securities for purposes of the Companies Act, 2008.

Section 140A(2) of the Companies Act, 1973 sets out who is deemed to have a beneficial interest in a security. The corresponding section in the Companies Act, 2008 is section 56(2) which provides the following:

“A person is regarded to have a beneficial interest in a security of a public company if the security is held \textit{nomine officii} by another person on that first person’s behalf, or if that first person—

\begin{enumerate}
\item[(a)] is married in community of property to a person who has a beneficial interest in that security;
\item[(b)] is the parent of a minor child who has a beneficial interest in that security;
\item[(c)] acts in terms of an agreement with another person who has a beneficial interest in that security, and the agreement is in respect of the co-operation between them for the acquisition, disposal or any other matter relating to a beneficial interest in that security;
\item[(d)] is the holding company of a company that has a beneficial interest in that security;
\item[(e)] is entitled to exercise or control the exercise of the majority of the voting rights at general meetings of a \textit{juristic person} that has a beneficial interest in that security; or
\item[(f)] gives directions or instructions to a \textit{juristic person} that has a beneficial interest in that security, and its directors or the trustees are accustomed to act in accordance with that person’s directions or instructions." \textit{(my underlining)}
\end{enumerate}

A comparison between section 140A(2) and section 56(2) reveals that section 56(2) implies that a beneficial security can only be held in respect of a security of a “public company.” In terms of the Companies Act, 2008, a “public company” means a profit

\textsuperscript{446} S 1 of the Companies Act, 2008.
\textsuperscript{447} See s 1 of the SSA and paragraph 2 2 above.
\textsuperscript{448} For a definition of a “private company” see footnote 451 below.
company that is not a state-owned company, a private company or a personal liability company. It is, accordingly, submitted that a beneficial security cannot be held in respect of a security issued by a non-profit company. This comparison further reveals that section 140A(2) refers to a “body corporate or trust”, whereas section 56(2) refers to a “juristic person.” In terms of the Companies Act, 2008 a “juristic person” includes a foreign company and a trust, irrespective of whether or not it was established within or outside the Republic. It is clear that by referring to the broader concept of “juristic person”, rather than just a body corporate or trust, the legislature intended to widen the application of section 56.

3.3.3.1 Disclosure of Beneficial Interests

Sections 140A(3) and 140A(4) deal with disclosures by registered shareholders of the beneficial interests held in their securities. The corresponding sections in the

\[\text{S 8 of the Companies Act, 2008 states that “[t]wo types of companies may be formed and incorporated under this Act, namely profit companies and non-profit companies.} \]

\[\text{(2) A profit company is} \]

\[\text{(a) a state-owned company; or} \]

\[\text{(b) a private company if} \]

\[\text{(i) it is not a state-owned company; and} \]

\[\text{(ii) its Memorandum of Incorporation -} \]

\[\text{(aa) prohibits it from offering any of its securities to the public; and} \]

\[\text{(bb) restricts the transferability of its securities;} \]

\[\text{(c) a personal liability company if} \]

\[\text{(i) it meets the criteria for a private company; and} \]

\[\text{(ii) its Memorandum of Incorporation states that it is a personal liability company; or} \]

\[\text{(d) a public company, in any other case.”} \]

In terms of s 1 of the Companies Act, 2008 a “non-profit company” means “a company -

\[\text{(a) incorporated for a public benefit or other object as required by item 1(1) of Schedule 1;} \]

\[\text{and} \]

\[\text{(b) the income and property of which are not distributable to its incorporators, members, directors, officers or persons related to any of them except to the extent permitted by item 1(3) of Schedule 1.”} \]

\[\text{S 1 of the Companies Act, 2008 states that “an enterprise that is registered in terms of this Act as a company, and either} \]

\[\text{(a) falls within the meaning of “state-owned enterprise” in terms of the Public Finance Management Act No. 1 of 1999; or} \]

\[\text{(b) is owned by a municipality, as contemplated in the Local Government: Municipal Systems Act No. 32 of 2000 and is otherwise similar to an enterprise referred to in paragraph (a).”} \]

\[\text{In terms of s 1 of the Companies Act, 2008 a private company means “a profit company that –} \]

\[\text{(a) is not a company or a personal liability state-owned company; and} \]

\[\text{(b) satisfies the criteria set out in section 8(2)(b).”} \]

\[\text{In terms of s 1 of the Companies Act, 2008 a personal liability company means “a company whose Memorandum of Incorporation states that the company is a personal liability company, as contemplated in section 8(2)(c).”} \]

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Companies Act, 2008 are sections 56(3) and 56(4). Section 56(3) provides the following:

“(if a security of a public company is registered in the name of a person who is not the holder of the beneficial interest in all of the shares in the same company held by that person, that registered shareholder must disclose –

(a) the identity of each person with a beneficial interest in the shares held by that person; and

(b) the identity of each person with a beneficial interest in securities so held, the number and class of securities held for each such person with a beneficial interest, and the extent of each such beneficial interest.” (my underlining)

Section 56(4) requires that the abovementioned information must “be disclosed in writing to the company within five business days after the end of every month, during which a change has occurred in the information contemplated in subsection (3), or more promptly or frequently to the extent provided by the requirements of a central securities depository; and or otherwise be provided on payment of a prescribed fee charged by the registered holder of securities.” (my underlining)

A comparison between these corresponding sections reveals that both Acts set out the same obligation, being that beneficial interests and the details pertaining to the beneficial interests must be disclosed within a certain time period. However, the following differences should be noted.

Firstly, section 140A(3) refers to securities “of an issuer” whereas section 56(3) refers to “a security of a public company.” This is in line with the earlier statement that a beneficial interest can only be held in respect of securities issued by public companies.454 Secondly, section 140A(4) requires that the information to be disclosed in terms of section 140A(3)455 must be furnished within seven days of the end of a three month period. Section 56(4) requires this information to be disclosed within five business day after the end of every month during which a change has occurred.456 The words “during which a change has occurred” have been inserted by

454 See paragraph 3 3 3 above.
455 S 56(3) of the Companies Act, 2008.
456 The difference between days and business days is discussed in paragraph 3 3 2 2 above.
the Companies Amendment Bill, 2010. It is submitted that this was done in order to restrict this obligation of disclosure to the event where such disclosure has an impact or is relevant to the other parties or entities involved. Finally, it should be noted that section 56(4) contains an additional provision not contained in the Companies Act, 1973. This section provides for disclosures of the prescribed information by registered holders of securities at times other than within five days after the end of every month, subject to payment of a prescribed fee to such registered holders of securities.

3.3.3.2 The Rights of a Company of Securities Regarding Beneficial Interests

Sections 140A(5) and 140A(6) set out the rights of a company to require, by notice and under specified circumstances, certain information regarding beneficial interests from its registered shareholders. The corresponding section in the Companies Act, 2008 is section 56(5) which provides the following:

“A company that knows or has reasonable cause to believe that any of its securities are held by one person for the beneficial interest of another, by notice in writing, may require either of those persons to—

(a) confirm or deny that fact;

(b) provide particulars of the extent of the beneficial interest held during the three years preceding the date of the notice; and

(c) disclose the identity of each person with a beneficial interest in the securities held by that person.”

A comparison between sections 140A(5) and 140A(6) and section 56(5) reveals that no significant differences exit. The only difference to be noted is that there is no corresponding section in the Companies Act, 2008 to section 140A(5)(b).

Section 140A(7) describes the time period within which the required information in terms of sections 140A(5) and 140A(6) needs to be furnished. The corresponding section in the Companies Act, 2008 is section 56(6) which provides that “[t]he information required in terms of subsection (5) must be provided not later than 10 business days after receipt of the notice.” (my underlining).

457 S 140A(5)(b) provides that a registered shareholder may charge a fee (as prescribed by the Minister) for the furnishing of information to the requesting company.
A comparison between these sections reveals that they are similar, except to the extent that section 140A(7) of the Companies Act, 1973 allows for 14 days within which to furnish the prescribed information after receipt of the notice and section 56(6) of the Companies Act, 2008 allows for 10 business days.\textsuperscript{458}

\textbf{3 3 3 3 The Obligations of a Company Regarding Beneficial Interests}

Section 140A(8) of the Companies Act, 1973 outlines the obligations of a company pertaining to disclosures of beneficial interests. The corresponding provision in the Companies Act, 2008 is section 56(7) which provides that:

A company that falls within the meaning of “regulated company” as set out in section 117(i) must –

(a) establish and maintain a register of the disclosures made in terms of this section; and
(b) publish in its annual financial statements, if it is required to have such statements audited in terms of section 30(2), a list of the persons who hold beneficial interests equal to or in excess of 5% of the total number of securities of that class issued by the company, together with the extent of those beneficial interests. (my underlining)

A comparison between these two sections reveals the following. Firstly, section 56(7) provides that the obligations specified in subsections (7)(a) and (7)(b) apply only to regulated companies which fall within the definition of “regulated company” as provided for in section 117(1)(i) of the Companies Act, 2008.\textsuperscript{459} This is not a requirement in terms of section 140A(8), as it provides that “all issuers” of securities are under such obligation. Secondly, section 56(7) provides that regulated companies, who are required to publish financial statements and which must be audited in terms of section 30(2), must publish other additional information in their annual financial statements. This information includes a “list of the persons who hold beneficial interests equal to or in excess of 5% of the total number of securities of that class issued by the company, together with the extent of those beneficial interests.

\textsuperscript{458} The difference between days and business days is discussed in paragraph 3 3 2 2 above.
\textsuperscript{459} See s 177(1)(i) and s 118 (1) and (2) of the Companies Act, 2008.
interests” in such annual financial statements.” Finally, no equivalent to section 140(8)(b) was included in the Companies Act, 2008.

It should be noted that sections 36(3) and 36(4) of the draft Regulation sets out the details which must be entered into a company’s securities register on receipt of any disclosures of beneficial interests.461

3.3.3.4 Additional Provisions as Contemplated in the Companies Amendment Bill, 2010

The Companies Amendment Bill, 2010 provides for additional provisions relating to voting rights by persons who hold beneficial interests in securities. These provisions are to be inserted after section 56(7). The relevant provisions read as follow:

“(8) Subsections (9) to (11) do not apply in respect of securities that are subject to the rules of a central securities depository.

(9) A person who holds a beneficial interest in any securities may vote in a matter at a meeting of shareholders, only to the extent that -
(a) the beneficial interest includes the right to vote on the matter; and
(b) the person’s name is on the company’s register of disclosures as the holder of a beneficial interest, or the person holds a proxy appointment in respect to that matter from the registered holder of those securities.

(10) The registered holder of any securities in which any person has a beneficial interest must deliver to each such person -
(a) a notice of any meeting of a company at which those securities may be voted on a matter, within 2 business days after receiving such a notice from the company; and
(b) a proxy appointment to the extent of that person’s beneficial interest, if the person so demands in terms of subsection (11).

(11) A person who has a beneficial interest in any securities that are entitled to be voted on a matter at a meeting of company’s shareholders may demand a proxy appointment from the registered holder of those securities, to the extent of that person’s beneficial interest, by delivering such a demand to the registered holder, in writing, or as required by the applicable requirements of a central securities depository.”

460 S 140(8)(b) requires that the register contemplated in section 140A(8)(a) (or s 56(7) in the Companies Act, 2008) needs to be open to inspection as if it was a register of members of the company.
461 See paragraph 3.3.2.5 above.
In summary, these provisions regulate voting rights by persons who hold beneficial interests in securities and their appointed proxies. The provisions set out two voting requirements, namely, that the beneficial interest must include the right to vote and that the relevant holder’s name or his/her proxy must have been entered into the company’s register of disclosure. The provisions also afford holders of beneficial interest in securities the right to demand a proxy appointment from the registered holders of those securities. This demand must be delivered in writing or as required in terms of the CSD Rules. It is important to note that the registered holders of securities must notify the relevant holders of beneficial interests of any meetings in which such persons are entitled to vote and if so demanded, deliver a proxy appointment as well. It is also important to note that these provisions will not apply in the circumstances where the CSD Rules apply.

3.3.5 Offences Relating to Beneficial Interests

Section 140A(12) provides that any person who fails to comply with any provision of section 140A, who failed to make a disclosure as required by section 140A or who made a false disclosure, is guilty of an offence. A comparison between the Companies Act, 1973 and 2008 reveals that no corresponding provision is contained in the Companies Act, 2008.

3.4 CONCLUSION

This chapter provided an overview of the securities settlement process in South Africa. It also examined the impact of the new Companies Act, 2008 on securities settlement. The focus fell on the specific provisions of the Companies Act, 1973 and 2008 dealing with the registration and transfer of uncertificated securities. This examination included the amendments as proposed in the Companies Amendment Bill [B40 - 2010] published on 10 November 2010. The rationale behind this examination was ascribed to the need for companies, holders of uncertificated securities and holders of beneficial interests in uncertificated securities to become conscious of their rights and obligations as affected by the promulgation of the Companies Act, 2008. The differences highlighted in this chapter can also be used
as a guideline by companies in amending their regulatory frameworks so as to ensure full compliance with the provisions as contained in the Companies Act, 2008.

This chapter commenced with an overview of the securities settlement process as performed, regulated and supervised by Strate. This was followed by an examination of the impact of the new Companies Act, 2008 on securities settlement in South Africa. To this end, an extensive gap analysis between the Companies Act, 1973 and the Companies Act, 2008 was completed in order to highlight the differences between the corresponding definitions, additional provisions to the Companies Act, 2008 as well as the provisions contained in the Companies Act, 1973 which were not included on the Companies Act, 2008. The gap analysis revealed the scope of the impact of the Companies Act, 2008 to be the following:

- the Companies Act, 2008 does not refer to a company’s register of members, but to a company’s securities register. Accordingly, all references to a company’s register of members in terms of the Companies Act, 1973 will be substituted with references to a company’s securities register;

- unlike the Companies Act, 1973, which defines “certificated securities” with reference to the SSA, the Companies Act, 2008 contains no such reference. It merely states that for purposes of the Act, “certificated” means “evidenced by a certificate”;

- the Companies Act, 2008 does not utilise the term “subregister”, but the term “uncertificated securities register.” In terms of the Companies Act, 2008, this term is defined as “the record of uncertificated securities administered and maintained by a participant or central securities depository, as determined in accordance with the rules of a central securities depository, and which forms part of the relevant company’s securities register established and maintained in terms of Part E of Chapter 2.” The SSA currently makes reference to and defines a subregister in terms of section 91A(1) of the Companies Act, 1973. Accordingly, this definition will have to be amended to reflect the term “uncertificated securities register” and its attributed definition as contained in the Companies Act, 2008;
section 53 of the Companies Act, 2008 provides that the transfer of ownership of uncertificated securities occurs despite any fraud, illegality or insolvency. The ground of insolvency were not contained in the Companies Act, 1973 and accordingly, in future, settlement of securities will take place despite insolvency;

unlike section 91A(5) of the Companies Act, 1973, section 53 includes the role and the rules of a CSD in conjunction with the role of a CSD Participant;

section 53(3) of the Companies Act, 2008 contains an additional provision in that it provides that section 51(5) of the Companies Act, 2008 applies to the transfer of ownership of uncertificated securities. Section 51(5) sets out the details a company must enter into its securities register concerning every transfer of uncertificated securities;

Sections 91A(4)(b), 91A(4)(d), 91A(4)(e) and section 91A(6) of the Companies Act, 1973 were not included in the Companies Act, 2008;

the provisions contained in section 50(3)(b)(ii) and section 52(2)(b) of the Companies Act, 2008 are additional. Section 50(3)(b)(ii) provides that the CSD Rules may also prescribe certain details which must be contained in the securities register to be established and maintained by a CSD or a CSD Participant in respect of the uncertificated securities held by them. Section 52(2)(b) provides that the inspection of uncertificated securities registers must be done, not only in accordance with the Companies Act, but with the CSD Rules as well;

sections 50(4) and 50(5) of the Companies Act, 2008 are additional. Section 50(4) provides that a securities register, or an uncertificated securities register, maintained, in accordance with the Companies Act, 2008, is sufficient proof of the facts recorded in it in the absence of evidence to the contrary. Section 50(5) provides that “[u]nless all the shares of a company rank equally for all
purposes, the company’s shares, or each class of shares, and any other securities, must be distinguished by an appropriate numbering system;"

- section 52(3) Companies Act, 2008 allows “five business days” from the date of request within which to produce the uncertificated securities register (obtained from the CSD or CSD Participant) for inspection. Section 91A(e)(ii) allows “seven days.” The difference between “business days” and “days” lies in the method of computation of time periods. When reference it made to “business days”, the first day is excluded, the last day is included and Saturdays, Sundays and public holidays are also excluded. However, when reference is made to “days”, it includes all the normal calendar days (which include Saturdays and Sundays and public holidays);

- there is no corresponding section contained in the Companies Act, 2008 to the provision in section 91A(3)(b) of the Companies Act, 1973, which provides that “no name of any person for whom a participant holds uncertificated securities as nominee shall form part of the subregister.” Hence, it can be concluded that, in the future, the names of such nominees will be included for the purposes of the securities register of a company;

- section 91A(10) of the Companies Act, 1973 which provides an offeree with a choice between certificated or uncertificated securities at such time that the securities are offered to him/her by the company concerned, is not included in the Companies Act, 2008;

- unlike section 91A(7) of the Companies Act, 1973, section 54 of the Companies Act, 2008 includes the role and the rules of a CSD in conjunction with the role of a CSD Participant;

- section 91A(7)(b)(i) of the Companies Act, 1973 provides a CSD or CSD Participant with seven days, after the receipt of a notice to convert certificated securities into uncertificated securities, to notify the relevant company and remove such details from its uncertificated securities register. The
corresponding section in 54(1) the Companies Act, 2008 provides for five business days;

- section 91A(7)(b)(iii) of the Companies Act, 1973 provides a company with 14 days within which to prepare the securities certificate and to notify the CSD that the securities are no longer held in certificated form. The corresponding section in section 54(2)(b) of the Companies Act, 2008 provides for 10 business days;

- section 54(2)(b) of the Companies Act, 2008 grants companies “20 business days in the case of holders of securities not resident within the Republic” to comply with section 54(2)(b). These 20 additional business days provided to non-residents of the Republic were not previously provided for in the Companies Act, 1973 and are, therefore, additional to the Companies Act, 2008;

- section 54(3) of the Companies Act, 2008 which entitles a company to elect to charge a fee to the holder of the securities who converts their securities from certificated to uncertificated form is an additional provision;

- section 91A(7)(b)(iv) of the Companies Act, 1973 was not included in the Companies Act, 2008;

- unlike the Companies Act, 1973, sections 55(2) and 55(3) of the Companies Act, 2008 include the roles and rules of a CSD in conjunction with the role of a CSD Participant. Two additional grounds for liability are also provided for in section 55(3)(b). This section provides that a CSD Participant or CSD may be held liable to indemnify any other person who suffers any direct loss or damage as a result of the transfer of uncertificated securities in accordance with an instruction that was not sent and properly authenticated, or a manner inconsistent with an instruction that was sent and properly authenticated in terms of the CSD Rules;

- no corresponding provision to section 91A(12) of the Companies Act, 1973, which provides for the offences and related liabilities which arise from the
contraventions specified in sections 91A(5)(a) and 91A(8) of the Companies Act, 1973, was included in the Companies Act, 2008. Chapter 9 of the Companies Act, 2008 which deals with offences and penalties also makes no specific reference to offences and liabilities arising from the registration and transfer of uncertificated securities;

- the additions to the Draft Regulations to the Companies Act, 2008 deal with:
  (a) the details which must be contained in the securities register of a profit company as required in terms of section 50(2)(b); (b) the details which must be entered into a company’s securities register on receipt of any disclosures of beneficial interests; (c) the manner in which a securities register must be kept; (d) the requirements for a company’s securities register which is held in electronic form; (e) the disposal of entries in a securities register where a person has ceased to hold securities in the company after seven years; and (f) the acquisition and loss of shareholder rights in securities held by shareholders;

- unlike its corresponding provisions in the Companies Act, 1973, section 56(1) of the Companies Act, 2008 provides that a company may state in its Memorandum of Incorporation that securities issued by the company may not be held by one person for the beneficial interests of another. This modification is of great significance as it places a limitation on the scope of beneficial interests in the companies’ environment;

- the definition of “beneficial interest” is amended in the Companies Act, 2008 to the following effect. Firstly, unlike section 140A(1), the definition contained in the Companies Act, 2008 specifies the ways through which a beneficial interest in a security can be obtained. Secondly, section 140A(1)(a) refers to “the right of entitlement to receive any dividend or interest payable in respect of that security,” whereas section 56(1)(a) refers to the right or entitlement to “receive or participate in any distribution in respect of the company’s securities.” Thirdly, whereas section 140A(1)(b) specifically mentions certain rights, such as voting, conversion and redemption rights, section 56(1)(b) does not mention any specific rights. It merely contains a general provision referring
to “any or all of the rights.” In the fourth instance, section 56(1)(c) contains an additional right not included in the Companies Act, 1973, being the right to “dispose or direct the disposition of the company’s securities, or any part of a distribution in respect of the securities….” Lastly, the Companies Act, 1973 makes reference to the now repealed Unit Trusts Control Act and accordingly, the Companies Act, 2008 makes reference to its successor, the Collective Investment Schemes Act;

- section 140A of the Companies Act, 1973, defines the terms “exchange” and “security” with reference to the now repealed SECA and the FMCA. Section 1 of the Companies Act, 2008 defined both these terms with reference to their meanings as set out in the SSA;

- the Companies Act, 2008 not only denotes to the term “securities” the meaning set out in section 1 of the SSA, but in addition also includes the shares held in a private company. It is clear that that shares held in a private company were specifically included in the definition of securities for purposes of the Companies Act, 2008;

- section 56(2) of the Companies Act, 2008 implies that a beneficial security can only be held in respect of a security of a “public company.” Accordingly, it was submitted that a beneficial security cannot be held in respect of a security issued by a non-profit company;

- section 140A(2) refers to a “body corporate or trust”, whereas section 56 (2) of the Companies Act, 2008 refers to a “juristic person.” In terms of the Companies Act, 2008 a “juristic person” includes a foreign company and a trust, irrespective of whether or not it was established within or outside the Republic. It is clear that by referring to the broader concept of “juristic person,” rather than just a body corporate or trust, the legislature intended to widen the application of section 56 of the Companies Act, 2008;
section 140A(3) of the Companies Act, 1973 refers to securities “of an issuer” whereas section 56(3) refers to “a security of a public company.” This was noted to be in line with an earlier statement that a beneficial interest can only be held in respect of securities issued by public companies;

section 140A(4) of the Companies Act, 1973 requires that the information to be disclosed in terms of section 140A(3) be furnished within seven days of the end of a three month period. Section 56(4) of the Companies Act, 2008 requires this information to be disclosed within five business day after the end of every month during which a change has occurred. The words “during which a change has occurred” was inserted by the Companies Amendment Bill, 2010. It was submitted that this was done in order to restrict this obligation of disclosure to the event where such disclosure has an impact or is relevant to the other parties or entities involved;

section 56(4) of the Companies Act, 2008 contains an additional provision not contained in the Companies Act, 1973. This section provides for the disclosures of prescribed information by registered holders of securities at times other than within five days after the end of every month, subject to payment of a prescribed fee to such registered holders of securities;

unlike section 140A(7) of the Companies Act, 1973, which allows for 14 days within which to furnish the prescribed information after receipt of the notice, section 56(6) of the Companies Act, 2008 allows for 10 business days;

section 56(7) of the Companies Act, 2008 provides that the obligations specified in subsections (7)(a) and (7)(b) apply only to regulated companies which fall within the definition of “regulated company” as provided for in section 117 (1)(i) of the Companies Act, 2008. This is not a requirement in terms of section 140A(8) of the Companies Act, 1973, as it provides that “all issuers” of securities are under such obligation;
• section 56(7) of the Companies Act, 2008 provides that regulated companies, who are required to publish financial statements and which must be audited in terms of section 30(2), must publish other additional information in their annual financial statements. This information includes a "list of the persons who hold beneficial interests equal to or in excess of 5% of the total number of securities of that class issued by the company, together with the extent of those beneficial interests" in such annual financial statements;"

• no equivalent to section 140(8)(b) of the Companies Act, 1973 was included in the Companies Act, 2008;

• the additional provisions introduced by the Companies Amendment Bill regulates voting rights by persons who hold beneficial interests in securities and their appointed proxies. The provisions set out two voting requirements, namely, that the beneficial interest must include the right to vote and that the relevant holder’s name or his/her proxy must have been entered into the company’s register of disclosure. These provisions also afford holders of beneficial interest in securities the right to demand a proxy appointment from the registered holders of those securities. This demand must be delivered in writing or as required in terms of the CSD Rules. It is important to note that the registered holders of securities must notify the relevant holders of beneficial interests of any meetings in which such persons are entitled to vote and if so demanded, deliver a proxy appointment as well. It is also important to note that these provisions will not apply in the circumstances where the CSD Rules apply.
CHAPTER FOUR
THE IMPACT OF THE GLOBAL ECONOMIC MELTDOWN ON THE LEGAL FRAMEWORK PERTAINING TO SELECTED SEGMENTS OF THE FINANCIAL MARKET

4.1 INTRODUCTION

This chapter aims to provide a background to the global economic meltdown. It also aims to discuss certain selected issues highlighted by the global economic meltdown and examine how they are currently regulated in the legal framework pertaining to the financial market. The selected issues include credit rating agencies, investor due diligence, crisis management tools, compensation structures, accounting and valuations standards, issuer transparency, market transparency and risk management. Lastly, this chapter aims to provide recommendations on regulatory reform where legislative gaps are highlighted. The recommendations will be based on an evaluation of the legislative measures proposed and taken by institutions providing international best practice.

4.2 BACKGROUND TO THE GLOBAL ECONOMIC MELTDOWN

The global economic meltdown had its origins in the United States (US) and more specifically in its housing sector. For some time, prospective US homeowners with low income and bad credit histories were given housing loans in disregard to all principles of financial prudence in lieu of huge bonuses and incentives to loan agents. As the repaying capacity of these borrowers was doubtful, these loans did not fall into the prime loan market, but were classified as “subprime loans.” Due to its risky nature, the interest rates charged on these loans were almost two percent
higher than those charged in the prime loan market. These subprime loans were also packaged into securitisation issues, called mortgage-backed securities. These MBS were sold to investors on the financial market. Major investment banks and institutions saw this as a good investing opportunity and bought huge amounts of these subprime loans from the original lenders, being the banks.

Overbuilding of houses during this period led to a surplus inventory of houses, causing home prices to decline and refinancing to become more difficult. In March 2008, an estimated 8.8 million houses were worth less than their mortgage (nearly 10.8% of the total of homeowners). As many subprime borrowers defaulted on their home loans and vacated their houses, lending companies (which were hoping to sell the houses and recover the loan amount) found themselves in a situation where the loan amount exceeded the total cost of the house. Accordingly, the lending companies had no option but to write off these losses. Needless to say, this was accompanied by a rapid loss of confidence in securitisation issues. As a result of these events, banks in the inter-bank market grew increasingly suspicious about each other’s solvency and ability to honour commitments. This attitude made it

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463 “Securitisation” refers to the process through which non-tradable assets (usually illiquid assets) become tradable in the financial market. Van Zyl et al Understanding South African Financial Markets 30 & 488. Internationally, these types of securities are also commonly referred to as “structured products”.

464 Mortgage-backed securities (hereinafter “MBS”).

465 To make the securitisation issues even more appetising to investors, mortgage insurance or credit default insurance such as credit default swaps were included in the package. For a definition of a “credit default swap” see footnote 340 above. Also see Goodspeed, I “Overview of the sub-prime market meltdown” http://www.financialmarketsjournal.co.za/6thedition/printedarticles/marketmeltdown.htm (accessed 03-01-2011).


difficult for companies to take loans for their needs and the global investment community became extremely risk-averse.\textsuperscript{468}

At the end of 2007, estimates based on a 14 percent default rate on subprime and Alt-A mortgages, suggested that potential losses in the mortgage sector of the United States could reach US$300 billion.\textsuperscript{469} By January of 2008, the chairperson of the US Federal Reserve stated that losses could climb to US$500 billion. In 2008, banks worldwide announced US$591 billion in write-offs and credit losses related to the subprime crisis. In September 2008, the IMF estimated the potential write-downs and losses relating to loans and securities at approximately US$1, 4 trillion.\textsuperscript{470}

On 6 February 2009, South Africa’s President, Kgalema Motlanthe, acknowledged in his State of Nation address that “[t]he global economic meltdown does pose serious dangers for our economy…”\textsuperscript{471} As a result of the global economic meltdown, the South African economy was expected to grow at a rate of three percent in 2009, whereas increases of five percent per year have been seen in the past.\textsuperscript{472} On 27 May 2009, it was confirmed that South Africa had joined the recession. This was deduced from the South Africa’s gross domestic product growth rate which had two consecutive quarters of negative growth (in the fourth quarter of 2008 and the first quarter of 2009) which is normally an indicator that an economy is in recession.\textsuperscript{473}

On 18 of August 2009, Statistics South Africa released the Gross Domestic Product figures for the second quarter of 2009 and it showed that South Africa had

\begin{footnotesize}
\begin{enumerate}
\item Blundell-Wignall “Structured Products: Implications for financial markets” Financial Market Trends 2007 27 42.
\item Ibid.
\end{enumerate}
\end{footnotesize}
experienced yet another negative quarter. Economists predicted a turnaround of the economy before the end of the 2009.

In the third quarter of 2009, it was confirmed that the US had pulled itself out of the recession. Studies by the US National Bureau of Economic Research confirmed the US time period of the global economic meltdown to be from December 2007 to June 2009. South Africa followed shortly thereafter with positive gross domestic product growth rates in both the third and fourth quarters of 2009.

Even though international financial markets seemed to have survived the global economic meltdown, it has highlighted that certain aspects of the regulatory and supervisory oversight of the financial markets are inadequate. The question that now arises is whether the South African legal framework pertaining to the financial market was and still is sufficiently robust to deal with the challenges posed by the global economic meltdown?

474 Mail & Guardian online “SA economy stuck in recession” http://www.mg.co.za/article/2009-08-18-sa-economy-stuck-in-recession (accessed 03-12-2010). This was the first instance of three consecutive quarters of negative growth since 1992.


4.3 ISSUES HIGHLIGHTED BY THE GLOBAL ECONOMIC MELTDOWN

4.3.1 Introduction

As noted above, the selected issues highlighted by the global economic meltdown to be discussed in this dissertation include credit rating agencies, investor due diligence, crisis management tools, compensation structures and accounting and valuation standards, issuer transparency, market transparency, risk management and liquidity.

4.3.2 Credit Rating Agencies

4.3.2.1 Introduction

A credit rating agency plays the following important role in the financial market:

“to independently differentiate credit quality across all industry sectors and investment instruments, with the purpose of providing investors with the information on which to base appropriate investment and pricing decisions. Accordingly, a formal rating provides an independent and internationally recognised measurement of an organisation's financial strength. A favourable rating can immediately result in an increased pool of investors, can facilitate direct access to capital markets and can ultimately result in reduced funding costs.”

The global economic meltdown has highlighted that CRAs failed to correctly assess the risks relating to financial instruments, especially derivative instruments. CRAs do not face any financial responsibility to cover losses from their mistakes. Accordingly, they have the incentive to under-estimate risks. Questions are being raised about the rating-process quality and standards utilised by CRAs as well as the over-reliance of investors on CRA ratings of securities. During the global economic meltdown in became apparent that CRAs' displayed poor practices in dealing with conflicts of interest, transparency of ratings and methodologies as well as the overall

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479 See paragraph 2.1 above.
480 Credit Rating Agency (hereinafter “CRA”).
quality of their ratings. Financial institutions also seem to have allowed CRA ratings to serve as a substitute for their own internal risk modeling. In other words, institutions in effect outsourced their own internal risk management to CRAs.

4322 International Best Practice

The G20 has recommended a more independent and credible system of surveillance, regulation and oversight of CRAs. Following this recommendation various international institutions have published legislative amendments and recommendations in this regard.

IOSCO has specifically included a designated principle relating to CRAs in its recently published *IOSCO Objectives and Principles of Securities Regulation*. This principle provides the following:

“Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.”

IOSCO also revised and updated its *Code of Conduct Fundamentals for Credit Rating Agencies* in August 2008 following the issues and insufficiencies highlighted by the global economic meltdown. The main issues reviewed were the quality and integrity of the rating process, independence and avoidance of conflicts of interest and the responsibilities of CRAs to the investing public and issuers.

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The European Commission has published the *EU Regulation on Credit Rating Agencies* which sets behavioral standards for CRAs. These standards include the increasing of transparency and improvement of standards of corporate governance. It also provides for the registration, regulation and supervision of CRAs.\(^{489}\) The Financial Stability Board published its *Principles for Reducing Reliance on CRA Ratings* in October 2010.\(^{490}\) These principles aim to reduce reliance on CRA ratings and to establish stronger internal credit risk assessment practices instead.\(^{491}\)

### 4.3.2.3 South Africa

CRAs are currently self-regulated in South Africa. The extent of this self-regulation entails compliance with the *Code of Conduct Fundamentals for Credit Rating Agencies* as well as the *IOSCO Objectives and Principles of Securities Regulation*.\(^{492}\) It has been argued by the Banking Sector Education and Training Authority (BANKSETA) that the application of the *Code of Conduct Fundamentals for Credit Rating Agencies* is in effect unenforceable in South Africa as CRAs themselves are responsible for the adoption of this Code. There is no designated institution or regulator responsible for the enforcement or monitoring of compliance. It has also argued that some of the provisions of the *Code of Conduct Fundamentals for Credit Rating Agencies* may not even be relevant to South Africa. However, enacting new legislation may be costly and has the potential to exclude South Africa from other foreign markets if it is not aligned with international best practice.\(^{493}\)

Following the recommendations of the G20, South Africa’s Finance Minister, Pravin Gordhan, recently announced that a Credit Rating Services Bill will be
promulgated. It is submitted that the focus of this Bill should fall the *Code of Conduct Fundamentals for Credit Rating Agencies*, the *IOSCO Objectives and Principles of Securities Regulation* and the Financial Stability Board’s *Principles for Reducing Reliance on CRA Ratings*. It should also seek to address the issues highlighted by the global economic meltdown. These issues include the role of CRAs, dealing with conflicts of interest, ensuring transparency of ratings and methodology as well as improving quality of ratings.

### 4.3.3 Investor Due Diligence

#### 4.3.3.1 Introduction

Investor due diligence entails that, in addition to the information given by issuers, investors should proceed with appropriate due diligence in order to ensure that they have a clear understanding of the different characteristics and risks involved in each type of investment they make. The global economic meltdown has raised some questions about the regulation of investor due diligence and whether investors have not been outsourcing their due diligence to CRAs.

#### 4.3.3.2 International Best Practice

The IMF’s has expressed its support for the notion of investor due diligence and has also encouraged investors to rely less on CRAs. The Financial Stability Board has undertaken to address the uses made by investors of CRAs ratings. To date nothing has been published in this regard.

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497 Ibid.

IOSCO recently published a document entitled *Good Practices in Relation to Investment Managers’ Due Diligence When Investing in Structured Finance Instruments*.\(^{499}\) This document encourages the use and implementation of tools by investors to assist in understanding complex financial products. However, as the name implies, this document only applies to structured products.

#### 4.3.3.3 South Africa

An analysis of the legal framework pertaining to the financial market reveals that there are no legislative measures providing for the regulation of investor due diligence. This raises serious concerns and it is submitted that an amendment to the current regulatory framework is of great importance. It is suggested that due diligence procedures should be clearly listed, e.g. a code of conduct, in order for investors to be attentive of what is expected of them and what measures they can take in order to protect themselves from market risks. Non-compliance by investors should be made subject to liabilities and/or sanctions.\(^{500}\) The IOSCO document on *Good Practices in Relation to Investment Managers’ Due Diligence When Investing in Structured Finance Instruments* may serve as a useful foundation for drafting such a code of conduct. It is further evident that there is a link between CRAs and the notion of investor due diligence. Accordingly, it is suggested that this proposed code of conduct be drafted in conjunction with the Credit Rating Services Bill.

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434 Crisis Management Tools

434.1 Introduction

Another issue highlighted by the global economic meltdown is the lack of tools for anticipating and managing systemic risks to regulators.\(^{501}\) It has been argued that once the situation in the US housing sector escalated into a crisis, regulators responded with inadequate crises management tools and infrastructures.\(^{502}\) Crisis management tools include the procedures for regulating a “failing, systemically critical institution without seriously damaging the financial system and the economy.”\(^{503}\) In this regard, cross-border crisis management by international authorities is also of great importance.

434.2 International Best Practice

The *IOSCO Objectives and Principles of Securities Regulation* provides that “[t]here should be a procedure for dealing with the failure of a market intermediary in order to minimise damage and loss to investors and to contain systemic risk.”\(^{504}\)

In its report on the actions taken or to be taken to promote financial regulatory reform, the G20 tasked the IMF to produce papers on a framework for the cross-border resolution of insolvent financial institutions.\(^{505}\) The IMF has published a working paper entitled *Crisis Management and Resolution for a European Banking System*. This working paper recommends an integrated crisis management framework and tools to deal cost-effectively with failing systemic cross-border

\(^{501}\) S 1 of the SSA defines systemic risk as “the danger of a failure or disruption if the Republic’s financial system as a whole.”


\(^{504}\) International Organisation of Securities Commissions *Objectives and Principles of Securities Regulation* June 2010 11.

banks. This working paper further recommends continuity of the core operations of financial institutions during crisis management, sustained efficiency and speed in addressing the problems as well as moral hazard containment.

The Financial Stability Board has established a Cross-border Crisis Management Working Group. In April 2009, this group issued recommendations for cross-border cooperation and crisis management entitled *FSF Principles for Cross-border Cooperation on Crisis Management*. These principles contain recommendations on the preparation for and management of a financial crisis. It also encourages frequent interaction and information sharing between international authorities regarding institutions that could pose systemic risks.

In its *Report and Recommendations of the Cross-border Bank Resolution Group*, the Cross-border Bank Resolution Group of the BCBS developed 10 recommendations for cross-border crises resolutions. These recommendations include the following: effective national resolution powers, frameworks for a coordinated resolution of financial groups, convergence of national resolution measures, cross-border effects of national resolution measures, reduction of complexity and interconnectedness of group structures and operations, planning in advance for orderly resolution, cross-border cooperation and information sharing, strengthening risk mitigation mechanisms, transfer of contractual relationships and exit strategies and market discipline.

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507 International Monetary Fund *Crisis Management and Resolution for a European Banking System* March 2010 28 & 29. The issue of moral hazard is discussed in paragraph 541 below.


510 Cross-border Bank Resolution Group (hereinafter “CBRG”).

Internationally, there is an expectation that central banks should deal with crisis management. Therefore, in the South African context, this responsibility is that of the SARB.\footnote{South African Reserve Bank South African Reserve Bank Annual Report 2009/10 28.} FSAP has recommended that the SARB reviews all strategies on crisis management.\footnote{South Africa Reserve Bank “Press release by the Registrar of Banks on the Annual Report 2008 of the Bank Supervision Department” http://www.reservebank.co.za/internet/publication.nsf/0/4D79B34533794396422575E60043A5E8?opendocument (accessed 05-12-2010).} In this regard, the IMF has also encouraged the SARB to explore the mechanisms and recommendations of other international authorities.\footnote{South African Reserve Bank Annual Report Bank Supervision Department 2008 14.}

The SARB has undertaken to establish crisis management groups for the major cross-border firms as well as a legal framework for crisis intervention.\footnote{South African Reserve Bank Annual Report Bank Supervision Department 2008 14.} It has also undertaken to review all strategies regarding crisis management as part of the work of the FSCF.\footnote{South African Reserve Bank Annual Report Bank Supervision Department 2009 22 & 23.} As a member of the Financial Stability Board it is expected that the \textit{FSF Principles for Cross-border Cooperation on Crisis Management} will be incorporated into the legal framework pertaining to the financial market. The SARB has indicated that its work on the implementation of these principles is ongoing.\footnote{The primary objective of the FSCF is “to identify potential crisis events that may threaten the stability of the South African financial market and to propose and obtain approval for appropriate plans, mechanisms and structures to prevent the realisation of threats or to mitigate their consequences. The BSD of SARB is represented at the FSCF and has undertaken to will monitor progress closely.” South African Reserve Bank Annual Report Bank Supervision Department 2008 12.}

On another level, it also should be noted that Strate is currently in the process of drafting a Participant Failure Manual. This Manual aims to regulate Participant Failure in a manner which alleviates or mitigates systemic risks and which is the least disruptive to the financial system.\footnote{Strate Limited Participant Failure Manual 20.} It is submitted that this Manual will serve as a significant crisis management tool should it be incorporated in to the legal framework pertaining to the financial market. This Manual and the notion of Participant Failure are discussed in Chapter Five below.
4.3.5 Compensation Structures

4.3.5.1 Introduction

As the global economic meltdown unfolded, it became evident that flawed compensation structures in financial institutions, which in turn led to excessive risk-taking, contributed to the crisis.\footnote{Bernanke “Financial regulation and supervision after the crisis: the role of the Federal Reserve” http://www.federalreserve.gov/newsevents/speech/bernanke20091023a.htm (accessed 10-11-2010).}

4.3.5.2 International Best Practice


4.3.5.3 South Africa

An evaluation of the legal framework pertaining to the financial market reveals that there are currently no legislative measures regulating compensation structures in...
South Africa. However, the JSE has developed its own compensation philosophy providing a robust framework for the effective governance of compensation. It is submitted that such a framework is too limited in scope and a national legal framework providing standards for the whole of the South African financial framework should be drafted. The JSE’s compensation framework can, however, serve as a foundation for the drafting of such legislative measures.

It is submitted that compensation structures should be structured in a fair and reasonable manner. The factors to be taken into account should include the size and role of the specific entity in the South African financial sector, the nature of the entity’s business, its risk profile, the competitive environment, capital requirements, financial affordability and recognising individual contributions and collective results. There should also be a clear differentiation of employees based on responsibility, competencies and scarcity of skills.

As a member of the Financial Stability Board, it is expected that the FSF Principles for Sound Compensation Practices will be incorporated into the legal framework pertaining to the financial market. In the interim, a similar methodology to that of the BIS for assessing compliance with these principles is recommended. This methodology will also be able to serve as a good foundation for subsequent legislation.

436 Accounting Standards

4361 Introduction

During the global economic meltdown it became evident that an international accounting framework within which securities markets can operate is required. Questions have also been asked about the efficiency of the current international standards as well as the mechanisms for enforcing compliance.

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526 Ibid.
4.3.6.2 International Best Practice

The *IOSCO Objectives and Principles of Securities Regulation* provides that “accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.”

The IMF has, *inter alia*, recommended that the complexity of accounting standards for financial instruments be reduced and that clarity and consistency in the application of one set of international accounting standards be achieved.

In August 2009, the BCBS released high level accounting principles and standards to the International Accounting Standards Board, entitled *Guiding Principles for the Replacement of IAS 39*. It was drafted in response to the recommendations made by the G20 leaders in April 2009.

The BCBS has stated that these principles “should facilitate continued, necessary coordination among standard setters, supervisors and regulators in their respective efforts to implement the G20 recommendations.”

These principles, *inter alia*, recommend that new accounting standards should be drafted in order to reflect the need for robust provisions and should promote a level playing field across jurisdictions.

In September 2009, the G20 agreed that international accounting bodies, including the International Financial Reporting Standards, must complete their efforts to achieve a single set of high quality, international accounting standards by June 2011.

However, in June 2010, these international accounting bodies jointly

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529 International Accounting Standards Board (hereinafter “IABS”).
announced that they have decided to delay certain project deadlines to the second half of 2011.  

4363 South Africa

The SSA provides for the regulation of accounting records and audit. It provides that a “regulated person” must –

“maintain on a continual basis the accounting records prescribed by the registrar and prepare annual financial statements that conform with generally accepted accounting practice and contain the information that may be prescribed by the registrar.”

Supplementary to the SSA is the SSA Board Notice on Accounting Records to be Maintained by a Regulated Person. This Notice sets out the specific accounting records which must be maintained by regulated persons, an exchange, a CSD, a clearing house, authorised users and CSD Participants. The FAIS regulates the accounting and audit requirements of financial services. The FSB Act provides for the accounting responsibility of the executive officer of the FSB.

In compliance with the SSA, the JSE Listing Requirements and BESA Listing Disclosure Requirements require compliance with the South African Statements of Generally Accepted Accounting Practice, which in turn, have now been fully

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536 S 89.
537 As defined in paragraph 2.2 above.
538 S 89(1).
539 These terms have been defined in paragraph 2.2 above. In addition to the SSA and the Board Notice, CSD Rule 8.1.1 provides that its Controlling Body may, in addition to the accounting records prescribed by the SSA, “determine the nature and type of reports, Accounts and Records which a Participant shall maintain for the purpose of the requirements of the Act and Rules.”
541 S 19.
542 S 17.
543 S 18.13 of the JSE Listing Requirements.
544 S 5.13 of the BESA Listing Disclosure Requirements.
545 South African Statements of Generally Accepted Accounting Practice (hereinafter SA GAAP).
aligned with IFSR.\textsuperscript{546} It is submitted that the South African legal framework will have to be revised when the new international accounting standards are published in 2011. It is also suggested that specific national legislation regulating compliance of all regulators and financial institutions with SA GAAP and IFRS be enacted in order to provide a more uniform legal framework in this regard.

4 3 7  Issuer Transparency

4 3 7 1  Introduction

Issuer transparency relates to the disclosure of information by issuers of securities regarding the nature and complexity of the financial instruments issued to investors. During the global economic meltdown it became apparent that certain issuer transparency measures were not sufficiently regulated or aligned and therefore, also contributed to the crisis.\textsuperscript{547}

4 3 7 2  International Best Practice

The Financial Stability Board has tasked IOSCO to assess and enhance issuer transparency and disclosure principles. The \textit{IOSCO Objectives and Principles of Securities Regulation} provides that “[t]here should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors’ decisions.”\textsuperscript{548} IOSCO has also proposed that sanctions or liabilities be imposed on those liable to take responsibility upon failure to adhere to any of the disclosure rules. However, provision is made for circumstances requiring something less than full disclosure.\textsuperscript{549} In these circumstances, temporary suspensions from trading or restrictions on the trading activities of those who possess more complete information are proposed by IOSCO.\textsuperscript{550}

\textsuperscript{546} Puttick & Van Esch \textit{The Principles and Practice of Auditing 8\textsuperscript{th} Ed} (2008) 49.


\textsuperscript{548} International Organisation of Securities Commissions \textit{Objectives and Principles of Securities Regulation} June 2010 8.

\textsuperscript{549} For instance, incomplete negotiations or trade secrets.

South Africa

The SSA regulates the disclosure of information by issuers of listed securities to registered shareholders/clients and to the relevant exchange.\textsuperscript{551} The SSA provides that an exchange may require issuers to disclose certain information regarding listed securities to the holder of the securities within a specific time.\textsuperscript{552} The failure to do so may result in the suspension of the exchange.\textsuperscript{553}

The JSE Listing Requirements\textsuperscript{554} provide that the JSE may, by notice in writing, require an applicant issuer to publicly disclose the information, as disclosed to the registered holders of the securities, if it will be in the public interest. The JSE Listing Requirements further require:

\begin{quote}
  “an applicant issuer to provide for the publication or dissemination of any further information not specified in the Listings Requirements in such form and within such time limits, as it considers appropriate. The applicant issuer must comply with such requirement and, if it fails to do so, the JSE may publish the information after having heard representations from the applicant issuer or after having granted the applicant issuer the opportunity to make such representations.”\textsuperscript{555}
\end{quote}

The JSE Equities Rules\textsuperscript{556} require disclosures of information by the JSE Members\textsuperscript{557} in rendering services to their clients.\textsuperscript{558} In summary, these Rules state the required

\footnotesize
\begin{itemize}
  \item S 15.
  \item S 15(1)(b).
  \item S 15(1)(c).
  \item S 1.25 of the JSE Listing Requirements.
  \item S 1.26 of the JSE Listing Requirements.
  \item In terms of S 8.10.3 of the JSE Equities Rules, members are obliged in to adhere to the following provisions:
  \begin{itemize}
    \item \textsuperscript{8.10.3.1} Disclosure to clients
      \begin{itemize}
        \item \textsuperscript{8.10.3.1.1} In rendering a service to a client, any representations made and information provided by a member -
          \begin{itemize}
            \item \textsuperscript{8.10.3.1.1.1} must be factually correct;
            \item \textsuperscript{8.10.3.1.1.2} must be provided in plain language, avoid uncertainty or confusion and not be misleading;
            \item \textsuperscript{8.10.3.1.1.3} must be adequate and appropriate in the circumstances of the particular service, taking into account the factually established or reasonably assumed level of knowledge of the client;
            \item \textsuperscript{8.10.3.1.1.4} must, as regards all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein, be reflected in specific monetary terms, provided that where any such amount, sum, value, charge, fee, remuneration or
      \end{itemize}
  \end{itemize}
\end{itemize}
\end{itemize}
quality of representations and information to be disclosed to investors as well as prohibited disclosures.

The BESA’s Listing Disclosure Requirements\textsuperscript{559} requires and regulates the minimum disclosures which investors would reasonably require for the purpose of making an informed assessment of the nature and state of an issuer’s business.\textsuperscript{560} Unlike the JSE Equities Rules, the BESA Rules do not contain any provisions on issuer transparency after securities have been listed.

It is submitted that the JSE Equities Rules, JSE Listing Requirements and BESA Listing Disclosure Requirements sufficiently regulated issuer transparency. However, it is suggested that the BESA Rules be amended, in line with the JSE Equities Rules, to require issuers to disclose certain information regarding securities after it has been listed. As noted above\textsuperscript{561} the JSE is currently in the process of finalising new Listing Requirements consolidating the JSE Listing Requirements and the BESA Listing Disclosure Requirements. At this stage, it remains to be seen how this issue will be regulated. It is submitted that this should be used as an opportunity to remedy the deficiencies of the BESA Rules in this regard.

\begin{itemize}
\item \textbf{8.10.3.2} A member -
\item \textbf{8.10.3.2.1} must disclose full and accurate information about the fees and any other charges that may be levied on clients;
\item \textbf{8.10.3.2.2} may not disclose any confidential information acquired or obtained from a client about such client, unless the written consent of the client has been obtained beforehand or disclosure of the information is required to further the objects of the Act or is required under any law;
\item \textbf{8.10.3.2.3} must advise a client in advance of any restrictions or limitations that may affect the access of that client to their assets.’’
\end{itemize}

\begin{footnotes}
\item \textsuperscript{557} S 1 of the JSE Equities Rules defines a “member” as an “equities member, which is a category of authorised user admitted to membership of the JSE under these rules.”
\item \textsuperscript{558} For a definition of “client” see paragraph 2.2 above.
\item \textsuperscript{559} S 5 of the BESA Listing Disclosure Requirements.
\item \textsuperscript{560} Introduction to the BESA Listing Disclosure Requirements.
\item \textsuperscript{561} Paragraph 2.5.2.6 above.
\end{footnotes}
Another important issue is the degree of transparency exhibited by FSPs\textsuperscript{562} to their clients in providing financial services. The FAIS Act requires a code of conduct for authorised financial services providers which “must be drafted in such a manner as to ensure that the clients being rendered financial services will be able to make informed decisions.”\textsuperscript{563} The FAIS Act further requires that the code of conduct must in particular contain provisions relating to the making of adequate disclosures of relevant material information.\textsuperscript{564} Accordingly, a \textit{General Code of Conduct for Authorised Financial Services Providers and Representatives} was published in 2003.\textsuperscript{565} This Code sets out the specific disclosure requirements a FSP must meet when rendering financial services.\textsuperscript{566} More specifically, it provides that FSPs must “provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision.”\textsuperscript{567}

At this stage it is also important to note that, until recently, there were no legislative measures specifically regulating consumers' most basic rights to information, disclosure, fairness, transparency, etc.\textsuperscript{568} In April 2009, President Kgalema Motlanthe, signed into law the Consumer Protection Bill B19D of 2008. This Bill has been enacted as the Consumer Protection Act 68 of 2008.\textsuperscript{569} This Act will come into force on 1 April 2011.\textsuperscript{570} The Act seeks to "prevent exploitation or harm on

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\textsuperscript{562} As defined in paragraph 2 3 3 2 above.
\textsuperscript{563} S 15(1)(a) and s 16(1).
\textsuperscript{564} S 16(2).
\textsuperscript{565} Financial Services Board Notice 80 of 2003.
\textsuperscript{566} S 3 (1)(a) provides that when a FSP renders a financial service, representations made and information provided to a client by the FSP -
"(i) must be factually correct;
(ii) must be provided in plain language, avoid uncertainty or confusion and not be misleading;
(iii) must be adequate and appropriate in the circumstances of the particular financial service, taking into account the factually established or reasonably assumed level of knowledge of the client;
(iv) must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction."
\textsuperscript{567} S 7(1).
\textsuperscript{568} Consumer Protection Bill B19D 2008.
consumers and to promote the social well being of consumers.” The Act also strives to protect consumers by providing them with adequate disclosure of standardised information in order to make informed choices. It is submitted that any further discussions on consumer protection will be too wide for purposes of this dissertation.

It submitted that the IOSCO Objectives and Principles of Securities Regulation and the additional recommendations made by IOSCO can also serve as a good guideline to policy makers in amending the current deficiencies in the legal framework pertaining to the financial market. Issuers should be required to disclose all material information regarding their financial instruments to ensure that investors are protected from making uninformed decisions. Sanctions for non-compliance by issuers should be imposed.

4.3.8 Market Transparency

4.3.8.1 Introduction

A financial system needs a certain degree of market transparency to function effectively and efficiently. Market transparency, as opposed to issuer transparency, concerns the degree to which information about trading in the market is made publicly available. The global economic meltdown highlighted certain weaknesses in the regulation of market transparency, especially in the secondary market.

4.3.8.2 International Best Practice

The IOSCO Objectives and Principles of Securities Regulation provides that regulation should promote transparency of trading. Before IOSCO approves the establishment of a new exchanges or trading system it assesses “the reliability of all
the arrangements made by the operator for the monitoring, surveillance and supervision of the trading system and its participants to ensure fairness, efficiency, transparency and investor protection, as well as compliance with securities legislation."\textsuperscript{576} (my underlining)

IOSCO has recently recommended secondary market trade reporting systems to provide the public with more prominent information regarding the frequency with which a given security trades and also the latest data on those trades. IOSCO further recommended that such a system should be designed to capture secondary market transactions even if the transactions are OTC.

Even though the G20 and the IMF have undertaken to address the issue of market transparency, nothing has, to date, been published in this regard.

\textbf{4.3.8.3 South Africa}

The JSE Listing Requirements requires disclosures of certain information by issuers of securities once any of its securities have been admitted to listing.\textsuperscript{577} These disclosures relates to material price sensitive information and trading statements. The JSE Listing Requirements\textsuperscript{578} provides the following:

\begin{quote}
\textbf{3.4 (a)} The following provisions apply in respect of material price sensitive information:
With the exception of trading statements, an issuer must, without delay, unless the information is kept confidential for a limited period of time in terms of paragraph 3.6, release an announcement providing details of any development(s) in such issuer’s sphere of activity that is/are not public knowledge and which may, by virtue of its/their effect(s), lead to material movements of the reference price of such issuer’s listed securities.
Save where otherwise expressly provided, the requirements of this paragraph are in addition to any specific requirements regarding obligations of disclosure contained in the Listings Requirements.
\textbf{(b)} Trading statements
All issuers, other than those who publish quarterly results, must comply
\end{quote}

\textsuperscript{576} International Organisation of Securities Commissions Objectives and Principles of Securities Regulation May 2003 42.

\textsuperscript{577} S 3 of the JSE Listing Requirements.

\textsuperscript{578} S 3.4 of the JSE Listing Requirements.
with the detailed requirements of paragraph 3.4(b)(i) to (vi). Issuers with a policy of publishing quarterly results must comply with the general principles contained in paragraph 3.4(b)(vii), but may also elect to comply with paragraph 3.4(b)(i) to (vi) on a voluntary basis.

From the above it is evident that issuers of listed securities must disclose certain details regarding developments in its sphere of activity which are not public knowledge and which may have the means of leading to material movements in the issuers listed securities’ reference price.\textsuperscript{579}

\textsuperscript{579} Section 3.4 (b) requires issuers, other than those who publish quarterly results, to must publish a trading statement as soon as they are satisfied that a reasonable degree of certainty exists. These financial statements must comply with subsections 3.4 (b)(i)–(vi). Issuers who publish quarterly results must comply with section 3.4 (b)(vii) and may elect to comply with sections 3.4 (b)(i)–(vi). Section 3.4 (b)(i) – (vi) provides the following:

(i) Issuers must publish a trading statement as soon as they are satisfied that a reasonable degree of certainty exists (refer to 3.4(b)(ii)) that the financial results (refer to 3.4(b)(v)) for the period to be reported upon next will differ by at least 20% from the most recent of the following (collectively referred to as the “base information”):

(1) the financial results for the previous corresponding period; or
(2) a profit forecast (in terms of paragraphs 8.35 to 8.44) previously provided to the market in relation to such period.

Issuers may publish a trading statement if the differences referred to in 3.4(b)(i) are less than 20% but which are viewed by the issuer as being important enough to be made the subject of a trading statement.

(ii) The determination of a reasonable degree of certainty in terms of 3.4(b)(i) is a judgmental decision which has to be taken by the issuer and its directors and is one in which the JSE does not involve itself. This determination may differ from issuer to issuer depending on the nature of business and the factors to which they are exposed.

(iii) Trading statements must provide specific guidance by the inclusion of a specific number or percentage to describe the differences. Issuers will also be permitted to use ranges (i.e. XYZ is expecting an increase of between 15% and 25%) to describe the differences. Where an issuer elects to use a range, the range may not exceed 20% (e.g. 20% to 40%, 25% to 45% etc). If, after publication of a trading statement but before publication of the relevant periodic financial results, an issuer becomes reasonably certain that their previously published number, percentage or range in the trading statement is no longer correct, then the issuer must publish another trading statement providing the revised number, percentage or range in accordance with paragraph 3.4(b).

(iv) In light of the existing Listings Requirements’ definitions of “significant”, “material” and “substantial”, these words may not be used in trading statements because to do so would imply a range differing from that permitted in terms of 3.4(b)(i) (i.e. more than 20%).

(v) Financial results in terms of 3.4(b)(i) are relevant criteria that are of a price sensitive nature which, in the first instance, comprise headline earnings per share (“heps”) and earnings per share (“eps”), and, in the second instance, and only if more relevant (because of the nature of the issuer’s business) net asset value per share (“navps”). If an issuer wishes to adopt navps, it must announce on SENS, in advance of the first period ending which uses such navps, that it will be adopting navps for trading statement purposes. Thereafter, such policy adoption must be confirmed annually in the annual financial statements.

(vii) In the event of an issuer publishing a trading statement, such issuer must either:

(1) produce and submit to the JSE a profit forecast or estimate, and accountants report thereon in accordance with:

(aa) ISAE 3400 – The Examination of Prospective Financial Information and the SAICA Revised Guide on Forecasts, in respect of profit forecasts; or
The BESA Rules\textsuperscript{580} set out the market transparency obligations for Inter-Dealer Brokers.\textsuperscript{581} In summary, it provides that Inter-Dealer Brokers must ensure market transparency by disclosing certain information regarding securities transactions. This information includes the identity, the price and the size of the securities transaction. The BESA Rules\textsuperscript{582} also require a market association to implement trading practices that contribute to the efficiency, security and transparency of the market, including a central price discovery mechanism.

It is submitted that JSE Listing Requirements and BESA Rules sufficiently address the issue of market transparency. It is suggested that a secondary market trade reporting system, such as recommended by IOSCO, be developed to provide the public with more prominent information regarding the frequency with which a given security trades and also latest data on those trades.

\textsuperscript{580} BESA Rule D.13 provides that:
\textsuperscript{581} An Inter-Dealer Broker is defined in the BESA Rules as “an authorised user who is registered only to act as a matched principal or name give-up inter-dealer broker to facilitate transactions in securities between -
\textsuperscript{582} BESA Rule C.1.3.3.
439 Risk Management

439.1 Introduction

The global economic meltdown has highlighted weaknesses in the risk management practices of regulators and financial institutions. Risk management refers to “the procedures and rules for understanding and controlling financial and other risks within an organisation.”

439.2 International best practice

As part of the BIS’s regulatory reform to address the fundamental weaknesses revealed by the global economic meltdown, the BCBS is currently finalising rules that will strengthen risk management standards.

The Financial Stability Board has published a report from the Senior Supervisors Group (SSG) on the issue of risk management. This group compiled the report in support of the Financial Stability Board’s undertaking to address the issue of risk management. The report is entitled, Risk Management Lessons from the Global Banking Crisis of 2008. This report identifies ten critical areas of needed improvement that encompasses governance, incentives, internal controls, and infrastructure.
The SSA provides that exchange rules must provide for prudent risk management requirements. In accordance with the SSA, the JSE Equities Rules, the JSE Derivative Rules, the Yield X Rules, JSE Equities Directives and BESA S 18 (2)(b)(i)-(ii).

JSE Equities Rules 4.70 provides that:
4.70.1 A member must employ the resources, procedures and technological systems necessary for the effective conduct of its business.
4.70.2 The system of internal control employed by the member must be designed to ensure that –
   4.70.2.1 the relevant business can be carried on in an orderly and efficient manner;
   4.70.2.2 financial and other information used or provided by the member is reliable;
   4.70.2.3 all transactions and financial commitments entered into by the member are recorded and are within the scope of authority of the member or the employee acting on behalf of the member;
   4.70.2.4 there are procedures to safeguard the assets of the member and assets belonging to any other person for which the member is accountable, and to control liabilities; and
   4.70.2.5 there are measures, so far as is reasonably practicable, to minimize the risk of loss to the member or the clients of the member which results from any irregularity, fraud or error and to detect any irregularity, fraud or error should they occur so that prompt remedial action may be taken by the member or the management of the member.

4.70.3 A member must adopt sound risk management principles and procedures appropriate to its business activities.
4.70.4 The principles and procedures of risk management must be designed to ensure that the records of the member are maintained in such a manner as to promptly disclose financial and business information that will enable the member or the management of the member to –
   4.70.4.1 identify, quantify, control and manage the risk exposures of the member;
   4.70.4.2 make timely and informed business decisions;
   4.70.4.3 monitor the performance and all aspects of the business of the member;
   4.70.4.4 monitor the capital of the member to ensure compliance with the capital adequacy requirements imposed in terms of the rules; and
   4.70.4.5 monitor the quality of the member’s assets.

4.70.5 A member must be able to describe and demonstrate the objectives and operation of such systems, principles and procedures referred to in rules 4.70.1 to 4.70.4 above to its auditor and to the JSE.

JSE Derivative Rules 16.10.9 provides that:
“A member shall employ effectively the resources and procedures that are necessary for the proper performance of its business activities and to eliminate, as far as is reasonably possible, the risk that clients will suffer financial loss through theft, fraud, other dishonest acts, poor administration, negligence, professional misconduct or culpable omissions. It shall organise and control its internal affairs in a reasonable manner and keep proper records. Its staff shall be suitable, adequately trained and properly supervised.”

Yield X Rule 10.220.9 provides that:
“Internal resources and risk management A member shall employ effectively the resources and procedures that are necessary for the proper performance of its business activities and to eliminate, as far as is reasonably possible, the risk that clients will suffer financial loss through theft, fraud, other dishonest acts poor administration, negligence, professional misconduct or culpable omissions. It shall organise and control its internal affairs in a reasonable manner and keep proper records. Its staff shall be suitable, adequately trained and properly supervised.”
Rules all contain legislative measures regulating internal resources and risk management.

The SARB has a Risk Management Policy to “ensure that risk management is performed in a co-ordinated, comprehensive and systematic manner that is consistent with internationally accepted standards and guidelines.” The SARBs

592 JSE Equities Directive DA2 provides that:

“2.1 In extending credit to a client or counterparty, either through a loan of funds, a loan of securities or an indulgence in relation to an obligation of a client or counterparty to the member, a member must ensure that –

2.1.1 the granting of credit does not compromise its ability to meet its financial resources requirements as specified in the rules and directives;

2.1.2 the granting of credit does not adversely impact its liquidity to the extent that it may not have sufficient funds to meet its short term commitments; and

2.1.3 the realisable value of any collateral or other security provided by the client or counterparty which reduces the exposure on which the member’s Counterparty Risk Requirement is calculated, in terms of DC 9.4, can be reliably measured.

2.2 In managing its credit risk and, specifically, in ensuring that it meets the requirements of DC 2.4.2, a member should measure and monitor its material credit exposures and any associated collateral or other security, on an ongoing basis, to ensure that actual and potential fluctuations in the value of the relevant loans or the security held against such loans do not adversely affect the member’s ability to meets its financial resources requirements.”

593 BESA Rule C10.3 provides that:

C10.3.1 An authorised user must ensure that it implements and maintains adequate internal control and risk management principles, as required by the Act.

C10.3.2 A compliance officer appointed in terms of Rule C2.4.2 must continuously monitor adherence to the principles of internal control and risk management referred to in Rule C10.3.1.

C10.3.3 The directors of the authorised user must submit a report to BESA within three months after the end of the authorised user’s financial year, certifying that –

C10.3.3.1 the authorised user has introduced and maintains internal audit procedures, internal control and risk management principles, and that these provide reasonable assurance as to the integrity and reliability of the authorised user’s financial statements;

C10.3.3.2 these internal control and risk management principles are based on established policies and procedures and, that these are being implemented by trained and skilled personnel whose duties have been properly segregated; and

C10.3.3.3 the authorised user and all its employees maintain high ethical standards thereby ensuring that the business practices of the authorised user are above reproach.

C10.3.4 An authorised user must forthwith report to BESA any indication that a material malfunction has occurred in the aforementioned principles and procedures.

This policy is largely based on the principles contained in the Committee of Sponsoring Organisations (COSO) Enterprise Risk Management Framework. The three distinct risk management processes used by the SARB include a strategic risk management process, a financial risk management process and an operational risk management process. South African Reserve Bank Annual Report 2008/2009 15 & 16.

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Board of Directors is responsible for the entire process of risk management and is assisted by the SARBs Audit Committee.\textsuperscript{595}

The FSB has established an Audit Risk Management Committee to, \textit{inter alia}, advise the FSB on the adequacy of its risk management processes and strategies. This Committee must “ensure that identified risks are monitored and appropriate measures are put in place and implemented to manage such risks.”\textsuperscript{596}

Strate has established an Enterprise Risk Management (ERM) Division which is responsible for its overall risk management function. This division, \textit{inter alia}, assists each division within Strate in identifying, assessing and measuring risks according to the probability of occurrence and the potential impact that the identified risk may have.\textsuperscript{597}

The Companies Act, 2008\textsuperscript{598} provides that an audit committee of a company needs to “perform other functions determined by the board, including the development and implementation of a policy and plan for a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes within the company.” (\textit{my underlining})

It is submitted that South Africa has a comprehensive framework regulating risk management. All the regulators have legislative measures or committees in place to regulate and ensure adequate risk management. As a member of the BIS it is expected that its revised rules and recommendations will be incorporated into the legal framework pertaining to the financial market once it has been finalised.

\textbf{4.4 CONCLUSION}

This Chapter provided a background to the global economic meltdown. This was followed by a discussion of certain selected issues highlighted by the global

\begin{footnotesize}
\begin{enumerate}
\item South African Reserve Bank \textit{Annual Report} 2008/2009 16.
\item Financial Services Board \textit{Annual Report} 2010 93 & 94.
\item Strate “Risk management” http://www.strate.co.za/aboutstrate/overview/risk\%20management.aspx (accessed 07-12-2010).
\item S 94(7)(i).
\end{enumerate}
\end{footnotesize}
economic meltdown and an examination of how they are currently regulated in legal framework pertaining to the financial market. This examination included recommendations on regulatory reform where legislative gaps were highlighted. The recommendations were based on an evaluation of the legislative measures proposed and taken by institutions providing international best practice. The selected issues were credit rating agencies, investor due diligence, crisis management tools, compensation structures, accounting and valuations standards, issuer transparency, market transparency and risk management.

The first issue discussed and examined was CRAs.

- CRAs are currently self-regulated in South Africa. The extent of this self-regulation entails compliance with the *IOSCO Code of Conduct Fundamentals for Credit Rating Agencies* as well as the *IOSCO Objectives and Principles of Securities Regulation*;

- it has been argued by BANKSETA that the *IOSCO Code of Conduct Fundamentals for Credit Rating Agencies* is in effect unenforceable in South Africa as there is no designated institution or regulator responsible for the enforcement or monitoring of this compliance. It has also argued that some of the provisions of the *Code of Conduct Fundamentals for Credit Rating Agencies* may not even be relevant to South Africa;

- enacting new legislation regulating the conduct of CRAs may be costly and has the potential to exclude South Africa from other foreign markets if it is not aligned with international best practice;

- a Credit Rating Services Bill is currently being prepared by the National Treasury. It was submitted that the focus of this Bill should fall on the *IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, IOSCO Objectives and Principles of Securities Regulation*, the Financial Stability Board’s *Principles for Reducing Reliance on CRA Ratings* and the specific issues highlighted by the global economic meltdown. These issues include the role
of CRAs, dealing with conflicts of interest, ensuring transparency of ratings and methodology as well as improving quality of ratings.

The second issue discussed and examined was investor due diligence.

- there are currently no legislative measures regulating investor due diligence in South Africa;

- it was suggested that investor due diligence procedures should clearly be listed, e.g. a code of conduct, in order for investors to be attentive of what is expected of them and what measures they can take in order to protect themselves from market risks. Non-compliance by investors should be made subject to liabilities and/or sanctions;

- it was submitted that the IOSCO *Good Practices in Relation to Investment Managers’ Due Diligence When Investing in Structured Finance Instruments* may serve as a useful foundation in drafting such a code of conduct;

- it was also suggested that the proposed code of conduct be drafted in conjunction with the Credit Rating Services Bill as there seems to be a link between CRAs and the notion of investor due diligence.

The third issue discussed and examined was crisis management tools.

- the SARB has committed itself globally to address cross-border resolutions and systemically important financial institutions by the end of 2010. To date, nothing has been published in this regard. The SARB has, however, indicated that it will continue to engage with the Financial Stability Board and its work on the implementation of the Financial Stability Board’s *Principles for Cross-border Co-operation on Crisis Management* is ongoing;

- the SARB has also undertaken to establish crisis management groups for the major cross-border firms as well as a legal framework for crisis intervention;
• Strate is currently in the process of drafting a Participant Failure Manual. This Manual aims to regulate Participant Failure in a manner which alleviates or mitigates systemic risks and which is the least disruptive to the financial system. It was submitted that this Manual would serve as a significant crisis management tool should it be incorporated into the legal framework pertaining to the financial market.

The fourth issue discussed and examined was compensation structures.

• there are currently no legislative measures regulating compensation structures in South Africa. It was suggested that specific national legislation to this effect be drafted. Guidance for these legislative measures can be obtained from the JSE’s current compensation philosophy;

• it was submitted that compensation structures should be structured in a fair and reasonable manner and the factors to be taken into account should include the size and role of the specific entity in the South African financial sector, the nature of the entity’s business, its risk profile, the competitive environment, capital requirements, financial affordability and recognising individual contributions and collective results. There should also be a clear differentiation of employees based on responsibility, competencies and scarcity of skills;

• it is expected that the FSF Principles for Sound Compensation Practices will be incorporated into the legal framework pertaining to the financial market. It was recommended that, in the interim, a similar methodology to that of the BIS for assessing compliance with these principles be used. This methodology will also be able to serve as a good foundation for subsequent legislation.

The fifth issue discussed and examined was accounting standards.

• the SSA requires regulated persons to conform to GAAP. Supplementary to the SSA is the SSA Board Notice on Accounting Records to be Maintained by
a Regulated Person. This Notice sets out the specific accounting records which must be maintained by regulated persons, an exchange, a CSD, a clearing house, authorised users and CSD Participants;

- in compliance with the SSA, the JSE Listing Requirements and the BESA Listing Disclosure Requirements require compliance with the South African Statements of Generally Accepted Accounting Practice, which in turn, have now been fully aligned with IFRS;

- it was submitted that the South African legal framework will have to be revised when the new international accounting standards are published in 2011. These international accounting standards are currently being drafted on the recommendations from the G20 and the BCBS;

- it was suggested that specific national legislation regulating compliance of all regulators and financial institutions with SA GAAP and IFRS be enacted in order to provide a more uniform legal framework in this regard.

The sixth issue discussed and examined was issuer transparency.

- it was submitted that the JSE Equities Rules, JSE Listing Requirements and BESA Listing Disclosure Requirements sufficiently regulate issuer transparency;

- it was suggested that the BESA Rules be amended, in line with the JSE Equities Rules, to require issuers to disclose certain information regarding securities after it has been listed. It was submitted that the new Listing Requirements consolidating the JSE Listing Requirements and the BESA Listing Disclosure Requirements should be used as an opportunity to remedy the deficiencies of the BESA Rules in this regard;

- it was noted that the FSB has published a General Code of Conduct for Authorised Financial Services Providers and Representatives to ensure that
the clients being rendered financial services will be able to make informed decisions;

- it was also noted that the Consumer Protection Act 68 of 2008 was recently promulgated and will come into force on 1 April 2011. This Act strives to protect consumers by providing them with adequate disclosure of standardised information in order to make informed choices. It was submitted that any further discussions on consumer protection would have been too wide for purposes of this dissertation;

- it was submitted that the *IOSCO Objectives and Principles of Securities Regulation* and the additional recommendations made by IOSCO can serve as a good guideline to policy makers in amending the current deficiencies in the legal framework pertaining to the financial market. Issuers should be required to disclose all material information regarding the financial instruments concerned so as to ensure that investors are protected from making uninformed decisions regarding financial instruments and liabilities. Sanctions for non-compliance by issuers should be imposed.

The seventh issue discussed and examined was market transparency.

- it was submitted that both the JSE Equities Rules and BESA Rules sufficiently regulates market transparency;

- it was, however, suggested that a secondary market trade reporting system, as recommended be IOSCO, be developed so that the public is provided with more prominent information regarding the frequency with which a given security trades and also latest data on the those trades.

The last issue discussed and examined was risk management.

- it was submitted that all the regulators have legislative measures or committees in place to regulate and ensure adequate risk management.
in compliance with the SSA, the JSE Equities Rules, JSE Derivative Rules, Yield X Rules, JSE Equities Directives and BESA Rules all contain legislative measures pertaining to the regulation of internal resources and risk management;

the SARB has a Risk Management Policy to ensure that risk management is performed in a coordinated, comprehensive and systematic manner that is consistent with internationally accepted standards and guidelines.

the FSB has established an Audit Risk Management Committee to, *inter alia*, advise the FSB on the adequacy of risk management processes and strategies. It is the responsibility of this Committee to ensure that identified risks are monitored and appropriate measures are put in place and implemented to manage such risks;

Strate has established an ERM Division which is responsible for its risk management function. This division effectively co-ordinates and manages the overall risk management program for Strate by assisting each division within the company to identify, assess and measure risks according to the probability of occurrence and the potential impact that the identified risk may have;

the Companies Act, 2008 requires an audit committee of a company to “perform other functions determined by the board, including the development and implementation of a policy and plan for a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes within the company.”

it was noted that one would expect the BIS’s revised rules and recommendations on risk management to be incorporated into the legal framework pertaining to the financial market once it has been finalised.
CHAPTER FIVE
PARTICIPANT FAILURE

5 1 INTRODUCTION

The success of the financial market in South Africa is dependent on investor confidence. However, such confidence is dependent on financial stability and market certainty with regard to the financial risks to which market participants are exposed when trading on the financial markets.\(^5\)\(^9\) Even before the global economic meltdown impacted on South Africa, some concerns were raised that the legal framework pertaining to the financial market does not contain comprehensive crisis management tools to provide procedures and regulate the legal position after the event of insolvency of a market participant.\(^6\)\(^0\) During the global economic meltdown this issue was highlighted yet again.\(^6\)\(^1\) In response, Strate is currently in the process of drafting a legal framework, the Participant Failure Manual, regulating the failure of market participants, referred to as “Participant Failure.” This Chapter aims to discuss the meaning of Participant Failure, provide an overview of the Participant Failure Manual and more importantly, discuss the impact of Participant Failure on settlement, as proposed by the Manual.

5 2 THE MEANING OF PARTICIPANT FAILURE

The term “Participant” refers to a CSD Participant.\(^6\)\(^2\) There are currently four types of Participants, namely Bank-Participants, Non-bank Participants, Full Participants and Corporate Participants. Bank-participants are “entities who are accepted as a Participant by Strate and who are also licensed as a bank under the Banks Act and

\(^6\)\(^0\) For a definition of “market participant” see footnote 85 above.
\(^6\)\(^1\) See paragraph 4 3 4 above.
\(^6\)\(^2\) As defined in paragraph 2 2 above. As noted, the term “Participant” will be used in this Chapter.
whose bank activities are regulated by the Bank Supervision Department of the SARB.\[^{603}\] Non-bank Participants are “entities who are accepted as a Participant by Strate and who are not licensed under the Banks Act, 1990."\[^{604}\] Full Participants are Participants who open and maintain Securities Accounts on behalf of Clients.\[^{605}\] Corporate Participants are “Participants who open and maintain Securities Accounts only for securities owned by it."\[^{606}\] Currently, 11 Participants have been accepted and are being supervised by Strate.\[^{607}\]

In terms of the Manual, the term “failure” is limited to the financial failure\[^{608}\] (the inability to pay debts) of a Participant and by implication the failure of a Client of a Participant is not catered for by the Manual. The term “failure” is limited specifically to the following events: curatorship,\[^{609}\] judicial management\[^{610}\] and/or liquidation.\[^{611}\] A discussion on each of these events follows below.

### 5.2.1 Curatorship

**5.2.1.1 Introduction**

Bank Participants\[^{612}\] are put under curatorship when it is unable to meet its financial obligations. The Banks Act\[^{613}\] also sets out the ground for a bank to be placed under curatorship and reads as follows:

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\[^{605}\] Strate Limited Participant Failure Manual 25. The term “client” is defined in paragraph 2 2 above. However for purposes of this chapter, the definition attributed in the Manual will be used. The Manual defines a "client" as "a third party, individual or organisation, who through a Broker or Participant, participates in the securities market for trading, custody and settlement."


\[^{607}\] These 11 Participants include the following Equities Participants: ABSA Bank Limited, Computershare Limited, FirstRand Bank Limited, Nedbank Limited, Sociètè Gènèrale - Johannesburg Branch and The Standard Bank of South Africa Limited. It also include the following Bonds Participants: ABSA Bank Limited, FirstRand Bank Limited, Nedbank Limited, the SARB and The Standard Bank of South Africa Limited. See Strate Limited “Participants” http://www.strate.co.za/supervision/participants/default.aspx (accessed 02-11-2010).

\[^{608}\] Accordingly, “failure” will not include disaster recovery or business continuity event.

\[^{609}\] See paragraph 5 2 1 below.

\[^{610}\] See paragraph 5 2 2 below.

\[^{611}\] See paragraph 5 2 3 below. Also see Strate Limited Participant Failure Manual 15.

\[^{612}\] As defined in paragraph 5 2 above.

\[^{613}\] S 69(1)(a).
“If, in the opinion of the Registrar, any bank will be unable to repay, when legally obliged to do so, deposits made with it or will probably be unable to meet any other of its obligations, the Minister may, if he or she deems it desirable in the public interest, with the written consent of the chief executive officer or the chairperson of the board of directors of that bank, appoint a curator to the bank.”

The appointment of a curator as well as its duties and powers are set out in the Banks Act.614 His/her appointment has the following consequences. Firstly, the management of the bank is vested in the curator, subject to the supervision of the Registrar. Secondly, any other person vested with the management of the affairs of that bank shall be divested thereof. Lastly, the curator must recover and take possession of all the assets of the bank.615

In terms of the Banks Act,616 a curator of a bank is bound by sections 35A, 35B and 46 of the Insolvency Act as if the curator was a trustee of an insolvent estate and the bank were an insolvent or a sequestrated estate as contemplated in these sections.

5 2 1 2 Section 46 of the Insolvency Act

Section 46 of the Insolvency Act provides the following:

“Set-off –

If two persons have entered into a transaction the result whereof is a set-off, wholly or in part, of debts which they owe one another and the estate of one of them is sequestrated within a period of six months after the taking place of the set-off, or if a person who had a claim against another person (hereinafter in this section referred to as the debtor) has ceded that claim to a third person against whom the debtor had a claim at the time of the cession, with the result that the one claim has been set-off, wholly or in part, against the other, and within a period of one year after the cession the estate of the debtor is sequestrated; then the trustee of the sequestrated estate may in either case abide by the set-off or he may, if the set-off was not effected in the ordinary course of business, with the approval of the Master disregard it and call upon the person concerned to pay to the estate the debt which he would owe it but for the set-off, and thereupon that person shall be obliged to pay that debt and may prove his claim against the estate as if no set-off had taken place: Provided that any set-off shall be effective and binding on the trustee of the insolvent estate if it takes place between an exchange or a market participant as defined in section 35A and any other party in

614 S 69 (1) to s 69(6).
615 S 69(2)(A).
616 S 69(6)(B).
accordance with the rules of such an exchange, or if it takes place under an agreement defined in section 35B." (my underlining)

In terms of this section\(^{617}\) it is clear that a trustee of an insolvent estate has as election to have any set-off\(^{618}\) which occurred up to six months prior to insolvency set aside in circumstances where such set-off did not occur within the ordinary course of business. In circumstances other than the abovementioned, post-insolvency set-off is prohibited and the creditors claiming such set-off against the insolvent estate are treated as concurrent creditors and must prove their claims accordingly.\(^{619}\) However, the proviso in this section provides for two exclusions where set-off will in fact be effective and binding on the trustee of the insolvent estate. The first exclusion relates to set-off which takes place between an exchange or a market participant as defined in section 35A\(^{620}\) and any other party in accordance with the rules of such an exchange. The second exclusion relates to set-off which takes place under an agreement defined in section 35B.\(^{621}\)

5213 Section 35A of the Insolvency Act

Section 35A\(^{622}\) sets out the legal position concerning transactions on an exchange\(^{623}\) in which the insolvent party is a market participant.\(^{624}\) This section provides the following.\(^{625}\)

(2) "If upon the sequestration of the estate of a market participant the obligations of such market participant in respect of any transaction entered

\(^{617}\) S 46 of the Insolvency Act.

\(^{618}\) Sett-off can be defined as "a method of cancelling or offsetting reciprocal obligations and claims (or the discharge of reciprocal obligations up to the amount of the smaller obligations)." See Bank for International Settlements "Glossary" at http://www.bis.org/publ/cpss00b.pdf?noreferrer=1 (accessed 23-10-2010).


\(^{620}\) Of the Insolvency Act. In terms of section 35A(1) an "exchange" refers to "an exchange as defined in section 1 and licensed under section 10 of the Securities Services Act, 2004, and for the purposes of this section includes a central securities depository as defined in section 1 of that Act and which is also licensed as a clearing house under section 66 of that Act, or a clearing house as defined in section 1 of that Act."

\(^{621}\) Of the Insolvency Act.

\(^{622}\) Of the Insolvency Act.

\(^{623}\) As defined in footnote 620 above.

\(^{624}\) As defined in footnote 85 above.

\(^{625}\) S 35A(2) – 35A(5) of the Insolvency Act.
into prior to sequestration have not been fulfilled, the exchange in question
in respect of any obligation owed to it, or any other market participant in
respect of obligations owed to such market participant, shall in accordance
with the rules of that exchange applicable to any such transaction be
titled to terminate all such transactions and the trustee of the insolvent
estate of the market participant shall be bound by such termination.

(3) No claim as a result of the termination of any transaction as contemplated
in subsection (2) shall exceed the amount due upon termination in terms of
the rules of the exchange in question.

(4) Any rules of an exchange and the practices thereunder which provide for
the netting of a market participant’s position or for set-off in respect of
transactions concluded by the market participant or for the opening or
closing of a market participant’s position shall upon sequestration of the
estate of the market participant be binding on the trustee in respect of any
transaction or contract concluded by the market participant prior to such
sequestration, but which is, in terms of such rules and practices, to be
settled on a date occurring after the sequestration, or settlement of which
was overdue on the date of sequestration.

(5) Section 341(2) of the Companies Act, 1973 (Act No. 61 of 1973), and
sections 26, 29 and 30 of this Act shall not apply to property disposed of in
accordance with the rules of an exchange."

In summary, this section provides that in the event of the insolvency of a market
participant, the exchange or any other market participant concerned, in respect of
obligations owed to it, may elect to terminate such transaction and the trustee of the
insolvent estate is bound by such election. Any consequential claim is limited to the
amount due as at the date of termination under the rules of the exchange.626 The
trustee of an insolvent participant is bound by the rules and practices of the
exchange concerned, providing for the:

a) netting of a market participant’s position; or
b) set-off in respect of transactions concluded by a market participant; or
c) opening and closing of a market participant’s position

if, in terms of such rules and practices, the transaction is to be settled on a date after
the sequestration, or settlement of the transaction is overdue on the date of
sequestration.627

626 In terms of s 35A(1) “exchange rules” refers to “exchange rules and depository rules as defined
in section 1 of the Securities Services Act, 2004.”
In terms of section 35A(5), section 341(2) of the Companies Act, 1973 as well as sections 26, 29 and 30 of the Insolvency Act are not applicable to property disposed of in accordance with the rules of an exchange. Section 341(2) of the Companies Act, 1973 provides that “[e]very disposition of its property (including rights of action) by any company being wound-up and unable to pay its debts made after the commencement of the winding-up, shall be void unless the Court otherwise orders.” In terms of the Companies Act, 1973 the winding-up of a company by the Court is deemed to commence at the time of the presentation to the Court of the application for the winding-up. Should property disposed of in accordance with the rules of an exchange not have been excluded from section 35A, this would have had a significant impact on the settlement of securities by Strate.

It is submitted that there is one aspect which requires careful reconsideration. This being section 35A(2), which provides that a trustee (being the curator or liquidator) is bound by the election of the exchange or the market participant. This subsection does not stipulate what the required procedure or timeline is in making such an election. It is, therefore, submitted that a redrafting of this subsection is necessary in order to clearly clarify the legal position in this regard.

628 Of the Insolvency Act.
629 In terms of s 1 the Insolvency Act, a “disposition’ is defined as “any transfer or abandonment of rights to property and includes a sale, lease, mortgage, pledge, delivery, payment, release, compromise, donation or any contract therefore, but does not include a disposition in compliance with an order of the court.”
630 S 348.
631 Of the Insolvency Act.
632 It should be noted that certain other sections, i.e. s 36 of the Insolvency Act has not been excluded in terms of s 35A. S 36 (1) provides that:
“If a person, before the sequestration of his estate, by virtue of a contract of purchase and sale which provided for the payment of the purchase price upon delivery of the property in question to the purchaser, received any movable property without paying the purchase price in full, the seller may, after the sequestration of the purchaser’s estate, reclaim that property if within ten days after delivery thereof he has given notice in writing to the purchaser or to the trustee of the purchaser’s insolvent estate or to the Master, that he reclaims the property. Provided that if the trustee disputes the seller’s right to reclaim the property, the seller shall not be entitled to reclaim it, unless he institutes, within fourteen days after having received notice that the trustee so disputes his right, legal proceedings to enforce his right.”
5214 Section 35B of the Insolvency Act

Unlike section 35A,\(^{633}\) which deals with insolvency proceedings pertaining to transactions concluded on an exchange, section 35B\(^{634}\) deals with the situation in informal markets\(^{635}\) where the insolvent party is a party to an agreement providing for termination and netting.\(^{636}\) In other words, it regulates the insolvency proceedings in transactions not concluded on an exchange, but by an agreement between the parties, where such an agreement provides for termination and netting.

Section 35B provides for post-insolvency set-off only in respect of a “master agreement.” Section 35B(2) defines a “master agreement” as:

“an agreement in accordance with standard terms published by the International Swaps and Derivatives Association, the International Securities Lenders Association, the Bond Market Association or the International Securities Market Association, or any similar agreement, which provides that, upon the sequestration of one of the parties —

(i) all unperformed obligations of the parties in terms of the agreement - (aa) terminate or may be terminated; or (bb) become or may become due immediately; and

(ii) the values of the unperformed obligations are determined or may be determined; and

(iii) the values are netted or may be netted, so that only a net amount (whether in the currency of the Republic or any other currency) is payable to or by a party, and which may further provide that the values of assets which have been transferred as collateral security for obligations under that agreement shall be included in the calculation of the net amount payable upon sequestration; or (b) any agreement declared by the Minister, after consultation with the Minister of Finance, by notice in the Gazette to be a master agreement for the purposes of this section.” (my underlining)

Accordingly, a master agreement includes any agreement which provides, upon the insolvency of a party to that agreement, for all unperformed obligations to be terminated, valued and set-off.

\(^{633}\) As discussed above.

\(^{634}\) Of the Insolvency Act.

\(^{635}\) Informal markets refer to OTC markets as discussed in paragraph 2.5.1 above.

\(^{636}\) In terms of the NPS Act, “netting” is defined as “the determination of the nett payment obligations between two or more clearing system participants within a payment clearing house or the determination of the nett settlement obligations between two or more settlement system participants within a settlement system.” The issue of netting is discussed in more detail below.
The rest of Section 35B reads as follows:

(1) “Notwithstanding any rule of the common law to the contrary, all unperformed obligations arising out of one or more master agreements between the parties, or obligations arising from such agreement or agreements in respect of assets in which ownership has been transferred as collateral security, shall, upon the sequestration of the estate of a party to such master agreement, terminate automatically at the date of sequestration, the values of those obligations shall be calculated at market value as at that date, the values so calculated shall be netted and the net amount shall be payable.

(3) The provisions of this section shall not apply to -
(a) a transaction contemplated in section 35A; or
(b) a netting arrangement contemplated in the National Payment System Act, 1998 (Act No. 78 of 1998).

(4) Section 341 (2) of the Companies Act, 1973 (Act No. 61 of 1973), and sections 26, 29 and 30 of this Act shall not apply to dispositions in terms of a master agreement.”

In summary, these subsections provide that all unperformed obligations arising out of a master agreement between the parties terminate automatically on sequestration. The market values of the obligations must be netted whereafter only the net amount will become payable. However, transactions contemplated in section 35A, a netting arrangement in terms of the NPS Act as well as certain provisions of the Companies Act, 1973 relating to dispositions made in terms of a master agreement are excluded from the application of Section 35B. The effect of section 35B is that the curator is bound by financial market agreements providing for termination and netting and accordingly, also by the legislation pertaining to the agreement, for instance, the exchange rules and the CSD rules.

5 2 1 5 Curatorship, the Manual and Current Legislation

It is important to note that the fact that a bank is placed under curatorship, does not necessarily imply that the bank qualifies as a “Failed Participant.” A bank under

637 S 35B(1).
638 Of the Insolvency Act.
639 S 35B(3). The NPS Act deals with netting arrangements in term of s8. For a discussion on s8, see paragraph 5 4 1 below.
640 S 35B(4). For a discussion on s 341(2) of the Companies Act, 1973 see paragraph 5 2 1 3 above and paragraph 5 2 3 3 below.
641 For example: the JSE Exchange Rules and the CSD Rules.
curatorship still continues to conduct its normal day to day business, subject to the terms of the curator’s appointment. Under certain circumstances curatorship may also even lapse. According to the Banks Act, curatorship may lapse either on the issue by the Minister of written notification to that effect or the winding-up of the bank in terms of the Banks Act.

A bank will only be regarded a “Failed Participant” and the procedures contained in the Manual will only commence once the curator:

- declares he will no longer honour the cash obligations of the bank and
- decides to terminate the banking license.

It is important to note that current legislation does not provide for the appointment and role of Strate, or its representative, as Failure Manager in the event that a Bank is regarded a Failed Participant. Nor does it even recognise the existence of the Manual. It is clear current legislation will have to be amended to this effect. The question which now arises is to what extent legislation should be amended.

Firstly, the SSA provides that Strate may only make CSD Rules on matters stipulated in section 39(2) and on additional matters, with the Registrar’s approval. As the appointment of Strate, or its representative, as Failure Manager is not provided for in section 39(2), the Registrar’s approval for such Rules and appointment will first need to be obtained.

Secondly, it is unclear what the relationship will be between the curator and the Failure Manager. Should the Failure Manager replace the curator and divest him/her of their duties and powers as stipulated in the Banks Act? This will clearly be a contradiction to the authority given to the SARB as lead regulator of all Banks. Strate Limited Participant Failure Manual 15. S 69(10). S 68. Strate Limited Participant Failure Manual 15. Also see s 8(3) of the NPS Act. These include the Curatorship Guidelines, the SSA, the Banks Act and the Insolvency Act. S 39(3). Also see paragraph 2 5 2 3 above. See paragraph 2 3 2 2 above.
Lastly, will the Failure Manager also be bound by sections 35A, 36B and 46 of the Insolvency Act as a curator in terms of the Banks Act? In order to ensure this, section 39 (4) of the SSA will first of all have to be amended. Section 39 (4) of the SSA currently states that the depository rules (the CSD Rules), are “binding on the central securities depository, a Participant, an issuer of securities deposited with the central securities depository and their officers and employees, and clients.” Accordingly, the SARB, FSB and JSE are not bound by the CSD Rules. In effect these regulators will not be bound, nor will their legislative frameworks be affected by the Manual when it is incorporated into the legal framework of Strate. This will lead to the absurd situation where the Banks Act, as administered by the SARB, will not be applicable to the Failure Manager and by implication, sections 46, 35A and 35B will be not apply to a Failure Manager. It is evident that the relationship between the curator and the Failure Manager needs to be clearly stated in the amended legislation as well as the role of the Failure Manager in relation to sections 46, 35A and 35B of the Insolvency Act.

5.2.2 Judicial Management

5.2.2.1 Introduction

Whilst Bank Participants are put under curatorship, Non-Bank Participants are put under judicial management. The Manual, in its current version, refers to the appointment of a judicial manager to a Non-bank Participant who is on the verge of financial failure. The Companies Act, 1973 sets out the grounds for judicial management as follow:

“When any company by reason of mismanagement or for any other cause –

(a) is unable to pay its debts or is probably unable to meet its obligations; and

(b) has not become or is prevented from becoming a successful concern, and there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or to meet its obligations and become a successful concern, the Court may, if it appears just and equitable, grant a judicial management order in respect of that company.”

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\[649\] S 427(1).
Judicial management entails that the management of the Non-bank Participant is placed under the control of the judicial manager who attempts to rescue the business of the Non-bank Participant from ultimate financial failure.

The company, a creditor, a member, the master, the judicial manager or the Minister may apply to court to have a company placed under judicial management. On the day of the application, the court grants a provisional judicial management order stating the return day, dismiss the application, or make any other order that it deems just. Should the court grant a provisional judicial management order, the Master must appoint a provisional judicial manager to take over the management of the company. Should a subsequent final judicial management order be granted, the final judicial manager takes over from the provisional judicial manager the management of the company and must apply any surplus funds to the costs of the judicial manager and to the creditors as it becomes available. Should the judicial manager not be able to return the company to solvency, he may recommend to the court that the Non-bank Participant be wound up.

The judicial officer has the power make an application to court to set aside voidable transactions. It should also be noted that several of the provisions of the Companies Act, 1973 relating to winding-up are, applicable to a company under judicial management as if such company are being wound up and the judicial manager were the liquidator in such circumstances.

5.2.2.2 The New Companies Act, 2008

It is extremely important to note that with the advent of the Companies Act, 2008, the judicial management system will be replaced with what is referred to as “Business Rescue.”

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650 In terms of s427 (2) read with s 346. Also see paragraph 5.2.3.3 below.
651 S 428(1).
652 S 428(2)(a).
653 S 434 (2).
655 S 436(1).
Business Rescue is defined in the section 128(1)(b) of the Companies Act, 2008 as –

“proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for –

(i) the temporary supervision of the company, and of the management of its affairs, business and property;
(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company.”

In terms of the Companies Act, 2008 a business rescue practitioner will be appointed to oversee a company during business rescue proceedings.657 A business rescue practitioner will be appointed in the event where a company finds itself “financially distressed.”658 Companies may either voluntarily initiate business rescue proceedings 659 or the court may order to begin rescue proceedings.660 It is submitted that the Manual should, therefore, be amended so as to reflect the amendments posed by the Companies Act, 2008 and that the relationship between the business rescue practitioner and the Failure Manager should be clearly stated.

5 2 2 3 Judicial Management, the Manual and Current Legislation

Unlike curatorship of a Bank-Participant,661 the procedures contained in the Manual will commence at the time the judicial manager is appointed and has agreed to accept Strate, or its representative, as Failure Manager.662 Strate, or its representative, will only be allowed to act as Failure Manager to a Non-bank

657 S 128 (1) (d) of the Companies Act, 2008.
658 S 128 (1) (f) defines the term “financially distressed” in reference to a particular company at any particular time as -
(i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or
(ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.
661 See paragraph 5 2 1 5 above.
Participant under judicial management once it has obtained the approval and assistance of the appointed judicial manager to act as such.

Currently, the SSA does not bind a judicial manager to accept the Failure Manager’s role or follow the procedures proposed in the Manual. It is submitted that the necessary legislative amendments should be made to this effect.\textsuperscript{663} The appointment of Strate, or its representative as Failure Manager in the event of judicial management of Bank Participants is also something which will need to be endorsed and acknowledgement by the Master of the Court.\textsuperscript{664}

\textbf{5 2 2 4 Recent Developments}

Section 136 of the Companies Act, 2008, which deals with the effect of business rescue on employees and contracts, provides that a business rescue practitioner may cancel or suspend any provision of an agreement to which a company in financial distress is a party to at the time of commencement of business rescue proceedings.\textsuperscript{665} However, this section is subject to certain exclusions, such as employment contracts and Master Agreements.\textsuperscript{666} In terms of the Companies Act, 2008\textsuperscript{667} it was not clear whether these agreements would be safe from business rescue proceedings. This issue has recently been clarified by the Companies Amendment Bill.\textsuperscript{668} Should this Bill be promulgated, section 136 will read as follows:

\begin{quote}
“(2) Subject to subsection (2A), sections 35A and 35B of the Insolvency Act, 1936 (Act No. 24 of 1936) and despite any provision of an agreement to the contrary, during business rescue proceedings, the practitioner may –

\begin{enumerate}
\item[(a)] entirely, partially or conditionally [cancel or] suspend, for the duration of the business rescue proceedings, entirely, partially or conditionally any obligation of the company that –

\begin{enumerate}
\item[(i)] arises under any provision of an agreement to which the company was a party at the commencement of the business
\end{enumerate}
\end{enumerate}
\end{quote}

\begin{footnotes}
\item[663] Strate Limited \textit{Participant Failure Manual} 16.
\item[664] Strate Limited \textit{Participant Failure Manual} 16 & 121.
\item[665] S 136(1).
\item[667] S 136(2).
\item[668] As discussed in paragraph 2 4 6 above.
\end{footnotes}
rescue period proceedings, other than an agreement of employment; and
(ii) would otherwise become due during those proceedings; or

(b) apply urgently to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any agreement to which the company is a party."

“2(A) When acting in terms of subsection (2) –

(a) a business rescue practitioner must not suspend any provision of -
(i) an employment contract; or
(ii) an agreement to which section 35A or 35B of the Insolvency Act, 1936 (Act No. 24 or 1936) applies.”

From the above it is clear that a business rescue practitioner will have to apply to court to cancel or suspend any agreement to which the company was a party to at the time of commencement of the business rescue proceedings. It is also clear that Master agreements will be safe from a business rescue practitioner in that this is unambiguously provided for.

5 2 3 Liquidation
5 2 3 1 Introduction

Bank-Participants as well as Non-bank Participants may be liquidated when it is deemed that they are unable to pay its debts. Liquidation refers to the process

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669  S 82(a) and s 83(b).
670  S 82(a).
671  S 83(b).
672  In terms of s345 of the Companies Act 1973, a company will be deemed to be unable to meet its debts when:
   "(1) A company or body corporate shall be deemed to be unable to pay its debts if-
   (a) a creditor, by cession or otherwise, to whom the company is indebted in a sum not less than one hundred rand then due-
       (i) has served on the company, by leaving the same at its registered office, a demand requiring the company to pay the sum so due; or
       (ii) in the case of any body corporate not incorporated under this Act, has served such demand by leaving it at its main office or delivering it to the secretary or some director, manager or principal officer of such body corporate or in such other manner as the Court may direct, and the company or body corporate has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor; or
   (b) any process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned by the sheriff or the messenger with an endorsement that he has not found sufficient disposable property to satisfy the judgment, decree or order or that any disposable property found did not upon sale satisfy such process; or
whereby an entity is dissolved or wound up. The Banks Act regulates the appointment of a liquidator to a Bank-Participant and the Companies Act, 2008 together with the Insolvency Act regulates the liquidation of a Non-bank Participant. Liquidation of a Bank-Participant has the effect that all cash with the bank, excluding securities, forms part of the assets of the bank and any depositors may prove claims against such assets (cash) in the normal course events. Liquidation of a Non-bank Participant has the effect that, firstly, the directors are divested of the control of the company. Secondly, the assets, excluding securities, of the Non-bank Participant are place under the control of the liquidator. Lastly, the Non-bank Participant may only continue business activities necessary for the winding up of the company.

In terms of the Companies Act, 1973 there are two circumstances in which a Company may be wound up, namely, by order of court or voluntarily. It should be noted at this stage that the Companies Act, 2008 provides that “Chapter 14 of the Companies Act, 1973 continues to apply with respect to the winding-up and liquidation of companies under this Act, as if that Act had not been repealed.” Therefore, the position with regards to the winding up of a company will remain unchanged when the new Companies Act, 2008 comes into force.

In terms of the Companies Act, 1973 a liquidator must “recover and reduce into possession all the assets and property of the company, movable and immovable, shall apply the same so far as they extend in satisfaction of the costs of the winding-up and the claims of creditors, and shall distribute the balance among those who are entitled thereto.” During this process the company continues to exist.

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673 The Companies Act, 1973 refers to the term “winding-up” and the Manual to “liquidation.” Accordingly, for the purposes of this dissertation both these terms will be used.
674 S 68.
675 Strate Limited Participant Failure Manual. Also see paragraph 5 4 2 1 below.
676 Ibid.
677 S 343(1).
678 Schedule 4, s 9.
679 S 391. The powers of a liquidator is set out in sections 386 to 390.
680 Also see s 69 2(A) of the Banks Act.
5232 Voluntary Liquidation

In terms of the Companies Act, 1973 a voluntary winding-up may be initiated by its members or its creditors.\(^{681}\) A voluntary winding-up is initiated by a special resolution passed by its members or by the creditors which, once passed, must be lodged with the Registrar within 28 days.\(^{682}\) Within 28 days thereafter, the company must lodge a certified copy thereof with the Master.\(^{683}\) The company will then be obliged to give notice of the voluntary winding-up in the Government Gazette.\(^{684}\) A copy of the resolution must then also be delivered to certain sheriffs of the High Court, the Magistrate’s Court and to certain registrars.\(^{685}\) A voluntary winding-up commences at the time of the registration of the special resolution authorising the winding-up.\(^{686}\)

5233 Liquidation by an Order of Court

An application to the court can be brought by the company, a creditor, a member, the master, the judicial manager or the Minister.\(^{687}\) The circumstances on which a court may wind up a company at the instance of an application includes the following: special resolution, premature commencement of business, non-commencement or suspension of business, minimum membership, lost share capital and the inability to pay debts.\(^{688}\) On the date of application, the court “may grant or dismiss any application for winding-up of a company, adjourn the hearing thereof conditionally or unconditionally, or make any interim order or any other order it may deem just.”\(^{689}\) The Court may not refuse to grant a winding-up order solely on the ground “that the assets of the company have been mortgaged to an amount equal to or in excess of those assets or that the company has no assets.”\(^{690}\) The winding-up of a company

\(^{681}\) S 343(2).
\(^{682}\) S 349 & s 352.
\(^{683}\) S 356(2)(a).
\(^{684}\) S 356(2)(b).
\(^{685}\) S 347(1)(a) & (b).
\(^{686}\) In terms of s 200 of the Companies Act, 1973.
\(^{687}\) S 346(1). Also see paragraph 5221 above.
\(^{688}\) S 344.
\(^{689}\) S 347(1).
\(^{690}\) Ibid.
by the Court shall be deemed to commence at the time of the application to the Court for the winding-up. 691

5 2 3 4 Liquidation, the Manual and Current Legislation

In terms of the Manual, a Failure Manager will be appointed once a liquidator has been appointed to wind down the business of the Failed Participant.692 It is submitted that, similar to curatorship and judicial management, the relationship between the Failure Manager and the liquidator will have to be stipulated in amended legislation. The legislation to be amended include, inter alia, the Banks Act.693 The Manual should also be amended to provide for the promulgation of the Companies Act, 2008. The appointment of Strate, or its representative as “Failure Manager” in the event of the liquidation of Bank-Participants and Non-Bank-Participant will also need to be acknowledged and endorsed by the Master of the Court.694

5 3 THE PARTICIPANT FAILURE MANUAL

5 3 1 Introduction

What follows below is an overview of the Participant Failure Manual, as drafted by Strate, and more importantly a discussion on the impact of Participant Failure on settlement and the securities account held by a Failed Participant.

5 3 2 An Overview

In terms of the SSA,695 it is the duty of Strate to “supervise compliance by participants with this Act and the depository rules.” As a result, Strate was tasked with the drafting of a legal framework regulating the event of the failure of any of the participants regulated and supervised by it. The Manual outlines procedures to ensure the settlement of trades already reported by a Failed Participant and to move the Failed Participant’s clients’ securities to accounts at alternative service providers.

691 S 348. Also see paragraphs 5 2 1 5 and 5 2 3 1 above.
693 S 68.
694 Strate Limited Participant Failure Manual 121.
695 S 33(c) of the SSA.
Strate has been assisted by the JSE. These two entities (collectively referred to as the Project Stakeholders of the Manual) have the essential skills, knowledge and expertise to develop such a legal framework. The input and observation of the FSB and the SARB have also been utilised during the development of the Manual.\textsuperscript{696}

An initial draft of the Manual was published by Strate in 2006. This version was, however, criticised for being too narrow in scope and focus. Consequently, in 2007, the Project Stakeholders appointed PricewaterhouseCoopers (PwC) to assist with the further development of the Manual and Version 1 was released in August 2008. However, certain amendments to this version were necessitated by the global economic meltdown and corporate failures during 2008. The need also existed to consider the impact of a Client failure causing the failure of a Participant, as well as the possibility of “multiple” Participant Failures. Version 2.0 was released and after careful consideration of the comments received by mainly Strate and the JSE, Version 3.0 was released in October 2009.\textsuperscript{697}

The Manual acknowledges that certain legislative changes are required to support the role and functions of Strate, or its representative, as Failure Manager and has set out the legislation to be reviewed as follow:

- The SSA
- The Rules and Directives of Strate;
- The Rules and Directives of the JSE (Equities/Yield-X and BESA);
- The Insolvency Act;
- The Banks Act;
- The SARB Curatorship Guidelines, and
- The system functionality of all the Participants, Strate, the JSE and BESA.\textsuperscript{698}

The proposed amendments to these legislative measures will be highlighted throughout the course of this chapter.

\textsuperscript{696} Strate Limited *Participant Failure Manual* 11.
\textsuperscript{697} Strate Limited *Participant Failure Manual* 12 & 13. This dissertation uses the most recent version.
\textsuperscript{698} Strate Limited *Participant Failure Manual* 14.
5 3 3  The Meaning and Responsibilities of the Failure Manager

The term “Failure Manager” is defined by the Manual as a “Strate representative or representatives who oversee the securities operations of a Failed Participant on behalf of the curator, liquidator or judicial manager.” At this stage it is not clear who and how many people will be eligible to be elected as a “representative” and it is submitted that Strate should clarify the position in this regard.

In terms of the Manual, the management of the failure process will include the following responsibilities to be carried out by the Failure Manager. Firstly, the Failure Manager must “[o]versee the finality of the settlement of transactions in the settlement timeline immediately following the declaration of a Participant Failure as defined.” Secondly, it must “[o]versee the migration of Client Securities Accounts to a new service provider after Clients have opened these accounts.” Lastly, it must “[o]versee the processing of Corporate Actions (Equities and Bonds) and Capital Events (Money market).”

It is important to note that, before the appointment of Strate, or its representative, as the Failure Manager of a Failed Participant can be made, an endorsement to this effect must be made by the FSB and the SARB. The Project Stakeholders are in the process of requesting such authorisation and it is anticipated that relevant Regulations in support of the Manual will need to promulgated as well as necessary amendments to the Curatorship guidelines. Currently the CSD Rules do not provide for the appointment of Strate, or its representative to act as Failure Manager. Therefore, the CSD Rules will have to be amended to provide for the event where a Failure Manager is appointed and the scope of its powers. Currently, the CSD

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699 See Strate Limited Participant Failure Manual 6. It is important to note that before the appointment of Strate, or its representative, as the Failure Manager of a Failed Participant can be made, an endorsement to this effect must be made by the FSB and the SARB. The Project Stakeholders are in the process of requesting such authorisation. The responsibilities associated with the appointment of Strate or its representative as the Failure Manager will be performed independently from its functions in terms of section 33(c) of the SSA.

700 Ibid.

701 Ibid.

702 Ibid.

703 Strate Limited Participant Failure Manual 13, 121 & 122. Also see paragraph 5 3 2 above.

Rules do not provide for the appointment of an interim manager under conditions of imminent danger.\textsuperscript{705} At this stage it is not clear whether this provision can be interpreted to include the appointment of a Failure Manager or whether it is capable of being amended to this extent.\textsuperscript{706}

It is proposed that the responsibilities associated with the appointment of Strate, or its representative, as the Failure Manager will be performed independently from its functions in terms of section 33(c) of the SSA.\textsuperscript{707} These functions include the termination of participation by a Participant. As such termination is a separate procedure, it will not be dealt with in terms of the Manual, but in terms of Strate Rule 3.10.1.1.\textsuperscript{708}

### 5.3.4 The Participant Failure Crisis Committee

According to the Manual, a Participant Failure Crisis Committee\textsuperscript{709} will be constituted on announcement of curatorship, judicial management (business rescue) or on the application for liquidation of any Participant and will oversee the operational aspects of the management of a Participant Failure.\textsuperscript{710} The PFCC will ensure that the actions and requirements determined by the Participant Failure Manual are executed and adhered to and will also monitor and report on the status of the management of the Participant Failure to the Strate Crisis Committee.\textsuperscript{711} Currently, the Strate Crisis Committee Plan does not provide for a notification to constitute the PFCC and therefore, the necessary amendments will need to be made in this regard.\textsuperscript{712}

Whilst discussing the PFCC, it is important to note the line of reporting from the PFCC. Once it has reported to the Strate Crisis Committee, it will be the responsibility

\textsuperscript{705} CSD Rule 3.9.1.
\textsuperscript{706} Strate Limited Participant Failure Manual 120.
\textsuperscript{707} See footnote 699 and paragraph 5.3.2 above.
\textsuperscript{708} CSD Rule 3.10.1.1 provides that “[t]he Controlling Body may terminate the participation of a Participant in terms if the Act under the following circumstances: the Participant is placed under curatorship, judicial management, or a liquidator is appointed, whether provisionally of finally, or the Participant makes a compromise or arrangement with its creditors.” Strate Limited Participant Failure Manual 17.
\textsuperscript{709} Participant Failure Crisis Committee (hereinafter PFCC).
\textsuperscript{710} Strate Limited Participant Failure Manual 18.
\textsuperscript{711} Strate Limited Participant Failure Manual 45.
\textsuperscript{712} Strate Limited Participant Failure Manual 122.
of the Chief Executive Officer of Strate to report to the Securities Registrar who will, in turn liaise with the CMD. The CMD will then have to decide whether to convene the FSB Market Crisis or SRO Incidents Committee, who respectively report to the Financial Sector Contingency Forum.\textsuperscript{713} This line of reporting is not currently provided for in neither the FSCF Guidelines on failure management nor the Terms of Reference of the Strate Crisis Committee and Market Crisis Committee of the FSB and this will have to be amended accordingly.\textsuperscript{714}

In terms of the Manual, the role of the FSCF will include, \textit{inter alia}, the preparation of certain communications to the general public. In the event of the failure of a Bank Participant, the FSCF will in most likelihood always prepare such media communications. In respect of the failure of a Non-bank Participant, these communications generally come from the liquidator of judicial manager (business rescue practitioner), but depending on the severity of the event, the FSCF may also be required to prepare such communications.\textsuperscript{715} Strate will need to clarify and familiarise itself with the requirements of the FSCF with regards to media releases in order to ensure that the Strate Crisis Committee and the Market Crisis Committee of the FSC complies with these requirements, should they become responsible for any media releases.\textsuperscript{716} It should also be highlighted that the extent to which the Manual provides for in this line of reporting/escalation procedure is limited to Participant Failure and does not deal with the position should the failure of a Participant have potential systemic implications. It is submitted that this position should clearly be catered for and necessary amendments to this effect should be made.

5 3 5 Stakeholders Roles and Responsibilities

Should one of the Participants within the financial market fail, other stakeholders involved will be affected as well. The Manual defines which market entities are regarded as stakeholders for the purposes of Participant Failure. These entities

\textsuperscript{713} Financial Contingency Forum (hereinafter “FSCF”).
\textsuperscript{714} Strate Limited Participant Failure Manual 46 & 122.
\textsuperscript{715} Strate Limited Participant Failure Manual 48.
\textsuperscript{716} Strate Limited Participant Failure Manual 122.
include, *inter alia*, CSD Participants,\(^{717}\) the JSE, Strate, the FSB, the Payments Association of South Africa (PASA) and the SARB.

The responsibility of the stakeholders will be to take the necessary measures to ensure failures are managed in the least disruptive and efficient manner. Their respective roles and responsibilities are set out by the Manual to include, *inter alia*, the following:

- Strate, or its representative, in its capacity as Failure Manager, will have to carry out the responsibilities pertaining to the Failure Manager as discussed above.\(^{718}\) As a Failure Manager, it will not assume any liabilities of theFailed Participant, but merely assist the curator, liquidator or judicial manager (business rescue practitioner) to continue the custody and settlement operation of the Failed Participant. Strate will, despite the operation of the Manual, continue to supervise the compliance of all participants in terms of the SSA\(^ {719}\) and the CSD Rules and Directives.\(^ {720}\)

- The JSE Settlement Authority will have various roles and responsibilities in respect of the equities market, the Yield-X market and the BESA market. In the equities market, the JSE Settlement Authority\(^ {721}\) will, during the failure period, need to monitor and manage settlement of On-Market transactions\(^ {722}\) and ensure the settlement of transactions in accordance with the JSE and CSD Rules and Directives.\(^ {723}\) In the Yield-X market, the JSE Settlement Authority\(^ {724}\) will have to monitor and manage settlement of On-Market transactions and

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\(^{717}\) As defined in paragraph 2.2 above.

\(^{718}\) See paragraph 5.5.3 above.

\(^{719}\) S 33 of the SSA.

\(^{720}\) Strate Limited *Participant Failure Manual* 21.

\(^{721}\) The JSE Settlement Authority is defined in the JSE Equity Rules s 1 as “the person or persons appointed by the JSE to manage the settlement of transaction in equity securities effected through the JSE equities trading system in terms of the rules and directives.”

\(^{722}\) In terms of the Manual “On-Market transactions” refer to “transactions in uncertificated securities which is concluded through the exchange (JSE) for settlement through the CSD.” Strate Limited *Participant Failure Manual* 8.

\(^{723}\) Strate Limited *Participant Failure Manual* 21.

\(^{724}\) In terms of s 2 of the JSE Yield-X Rules, the JSE Settlement Authority is defined as the “person or persons appointed by the JSE to manage the settlement of transactions in bonds effected through the Yield-X trading system in terms of the Yield-X Rules and Directives and the Strate Rules and Directives.”
ensure the settlement of transactions in accordance with the Yield-X and CSD Rules and Directives. The same applies to the JSE Settlement Authority of the BESA market in terms of the BESA and Strate Rules and Directives.

- The JSE Surveillance Division will have the responsibility of transferring the affected Authorised Users Accounts to another Participant in order to ensure the continuity of business of the affected Authorised Users and the effective safeguarding of the securities held by the Failed Participant.

5 3 6 Principle of Fail One, Fail All

This principle is endorsed by the Manual and relates to the issue of “netting.” Netting takes place at three levels, namely, the netting of securities at central securities account level (securities level), the netting of cash at participant level (cash level) and the netting of securities and cash at JSE member level (settlement group level). This principle applies to all these three levels of netting. In essence, this principle entails that should netting at any one of the three levels fail, netting at all levels will fail as a result. It is important to note that following the declaration on a Failed Participant, the CSD systems will continue to constitute obligations for the Failed Participant for those transactions which were reported, matched and committed to before the declared failure.

726 This division supervises compliance by of authorised users (as defined in Chapter Two) with the SSA and the Rules and Directives of the JSE. It is important to note that with the merger of the JSE and BESA, BESA’s Market Regulation Division was integrated into the Surveillance Division. The regulation relating to the trading aspects of cash bonds and binary options now falls within the JSE Surveillance Division. See JSE Limited “Market regulation” http://www.jse.co.za/Markets/Interest-Rate-Market/Marke t-regulation.aspx (accessed 20-11-2010).
727 For a definition of “authorised user” see paragraph 2 2 above.
728 Strate Limited Participant Failure Manual 22.
729 For a definition of the “netting” see footnote 390 above.
537 Client Failure

The Manual makes it clear that a client’s failure is not included in the definition of Participant Failure.\(^{731}\) Even though it is accepted by the Manual that the failure of a client can set off or ultimately cause the failure of a Participant, it does not include any procedures regulating the failure of a client of a Participant.\(^{732}\)

538 Multiple Failures

The Manual acknowledges that the global economic meltdown has highlighted the possibility that the failure of one Participant could cause the subsequent failure of another Participant. In order to cater for this position, the Manual provides that its proposed procedures will be would be followed for both failed entities. No additional or amended procedures will be published in this regard.\(^{733}\)

54 THE IMPACT OF PARTICIPANT FAILURE ON SETTLEMENT\(^{734}\)

The paragraphs below discuss the big questions and issues raised by the notion of Participant Failure: What is the impact of Participant Failure on settlement and what is the impact on the securities accounts held by the Failed Participant? Does settlement in fact take place and do the securities held by the Failed Participant in its securities accounts fall inside the scope of the Failed Participants assets, or is it excluded?

541 Settlements on Date of Failure

According to the Manual, it is current practice that curatorship of a bank is announced after close of business and as a result, settlements due for the following day will be difficult to apprehend. Therefore, the Manual provides in these

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\(^{731}\) The Manual defines the term “client” as a “third party, individual or organisation, who through a JSE equities member/ JSE BESA member/JSE Yield-X member or Participant, participates in the securities market for trading, custody and settlement.” Strate Limited Participant Failure Manual 5.


\(^{733}\) Strate Limited Participant Failure Manual 19.

\(^{734}\) The settlement process has been set out in paragraph 2 2 above.
circumstances no failure actions will take place and settlement will occur on such following day.\textsuperscript{735} This provision is supported by the assumption that the SARB, based on its undertaking to “manage” the failure of any bank in the payments arena, will provide the necessary liquidity on behalf of the failed bank\textsuperscript{736} to ensure that all cash settlements through SAMOS are effected for settlements due to occur on the day of failure.\textsuperscript{737} It is of extreme importance that confirmation of this position be obtained from SARB as soon as possible. Should the SARB elect not to do so, it will have a significant impact on the introduction, working and success of the Manual.

An important issue to consider in this regard is that of bailouts and moral hazard. It is feared that should SARB, as lender of last resort, bail out each and every bank in every time it faces a financial crisis, this could lead to excessive risk taking and poor risk management by banks. Then there is also the issue of timing. Should the SARB bail out a Participant too soon, it can increase the risk of moral hazard and favour bad banks/firms over good ones. Should the SARB act too slow, it may exacerbate the consequences.\textsuperscript{738} Should the SARB endorse this responsibility, it is submitted that that it will have to amend its legislative measure and principles in order to provide for these types of bail outs and for the effective regulation and supervision thereof.

The NPS Act\textsuperscript{739} provides that should a system participant\textsuperscript{740} be wound up or placed under judicial management or should a curator be appointed to a system participant -

\textsuperscript{735} Strate Limited \textit{Participant Failure Manual} 30.
\textsuperscript{736} Being a failed Bank-Participant or the Clearing Bank of a Non-bank Participant.
\textsuperscript{737} Strate Limited \textit{Participant Failure Manual} 30.
\textsuperscript{739} S 8(2) of the NPS Act..
\textsuperscript{740} In terms of s 1 of the NPS Act a “system participant” refers to a member of the payment system management body.
“any provision contained in a written netting agreement to which that system participant is a party, or any netting rules and practices applicable to the system participant, is binding upon the liquidator, judicial manager or curator, as the case may be, in respect of any payment or settlement obligation –

(a) which has been detained through netting prior to the issue of the winding-up order or judicial management order or the appointment of the curator, as the case may be; and
(b) which is to be discharged on or after the date of the winding-up order, judicial management order or the appointment of the curator, as the case may be, or the discharge of which was overdue on the date of the winding-up order, judicial management order or appointment of the curator, as the case may be.” (my underlining)

Accordingly, the NPS Act\(^\text{741}\) has the effect that security transactions, in the form of written netting agreements, already in the clearing and settlement system, must be settled despite curatorship, judicial management or liquidation. It is submitted that the Manual’s provisions relating to settlements on date of failure, therefore, corresponds with the NPS Act in this regard.

5 4 2 Settlements Following Date of Failure
5 4 2 1 Introduction

With regards to settlements following the date of failure, a distinction is first of all made between the impact of a Participant Failure on securities and the impact on cash. With the regard to securities, the current legal position is that securities held by a Participant is held in the capacity as an agent and accordingly are not trapped within a Failed Participant. The securities are “ring-fenced and do not form part of the pool of assets of the failed entity.” It is therefore, freely transferable.\(^\text{742}\)

This is, however, not the position of cash at a Failed Bank-Participant or Failed Clearing Bank\(^\text{743}\) of a Non-bank Participant, as cash is regarded as being trapped within such Failed Participant’s assets. By implication, this cash is not freely

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\(^{741}\) S 8(2) of the NPS Act.
\(^{742}\) Strate Limited Participant Failure Manual 31.
\(^{743}\) In terms of the Manual a “clearing bank” is defined as “a bank that is regulated by the Registrar of Banks and is permitted to clear and settle cash. It is a settlement system participant and a member of the payment Association of South Africa (PASA) as required by the National Payments System Act 1998.”
transferable. This position is catered for in the Banks Act\textsuperscript{744} which provides that the curator of a bank must take possession of all assets of the bank, which is inclusive of cash.\textsuperscript{745}

The issue which accordingly arises is that, as securities are freely transferable, one would expect all sale transactions to settle following the date of failure if the securities are available. However, this would also result in payment of the sale proceeds to the Failed Participant where it will be trapped and not be accessible to the client until the bank is put into liquidation or wound-up.\textsuperscript{746} In this regard, the Manual recommends the following procedures which will be discussed in turn:

- the transfer of securities from a Failed Participant to other Participants; and

- the re-routing of cash proceeds from settled sale transactions, collateral and Corporate Actions / Capital Event related cash receipts.

\textbf{5 4 2 2 Transfer of Securities From a Failed Full Participant to Other Participants}

With regard to the transfer of securities from a Failed Participant, the Manual provides that the CSD Rules,\textsuperscript{747} which provide for the migration of Client securities following the termination of a Participant’s acceptance by Strate, will regulate the procedures to be followed.\textsuperscript{748} The relevant CSD Rules provide the following:

\begin{quote}
“A Participant, its trustee, liquidator, curator, judicial manager, administrator or other lawful agent must, upon notification of the Participant’s termination, transfer all Securities Accounts to other Participants in accordance with Client instructions in terms of Rule 5.6.3.9, the Client Mandate, Rules and Directives.”\textsuperscript{749}
\end{quote}

\begin{flushright}
\footnotesize
\begin{itemize}
\item \textsuperscript{744} S 69(2)(a) of the Banks Act.
\item \textsuperscript{745} The terms cash includes all cash deposited with the bank before and after the appointment of a curator. It should, however, be noted that if one follows section 8 of the NPS Act, cash already in the NPS system are not trapped and settlement will take place accordingly. Strate Limited Participant Failure Manual 30.
\item \textsuperscript{746} Strate Limited Participant Failure Manual 31.
\item \textsuperscript{747} CSD Rules 3.10.2 and 3.10.
\item \textsuperscript{748} Strate Limited Participant Failure Manual 32.
\item \textsuperscript{749} CSD Rule 3.10.2.
\end{itemize}
\end{flushright}
“Where a Client has not provided a Participant with the instructions referred to in Rule 3.10.2 within 30 (thirty) calendar days of the Participant, its trustee, liquidator, Curator, judicial manager, administrator or other lawful agent giving notice to the Client of its termination in terms of Rule 5.7.7, the Participant, its trustee, liquidator, Curator, judicial manager, administrator or other lawful agent shall transfer the Client’s securities Account to another willing Participant in its discretion and advise the Client of the details of the receiving Participant.”

According to the above, all securities accounts of a Failed Participant must be transferred to other Participants, in accordance with its Client’s instructions. It may be transferred in the absence of such Clients’ instructions, if such instructions have not been received within 30 days from notice of the Participant’s failure given to the Client.

5 4 2 3 The Re-routing of Cash Proceeds From Settled Sale Transactions, Collateral and Corporate Actions / Capital Event Related Cash Receipts

With regards to the re-routing of cash proceeds from settled sale transactions, collateral and Corporate Actions and/or Capital Events related cash receipts, the Manual recommends that the cash proceeds from the settlement of such sale transactions should be diverted away from the Failed Participant using temporary cash suspense accounts opened specifically for this purpose.

The Manual assumes that Strate, or its representative, acting as the Failure Manager, will be permitted to open two cash bank accounts with another bank or banks, other than the Failed Bank-Participant or Clearing Bank of the Non-bank Participant. These accounts will respectively be termed “Cash Suspense Account” and “Corporate Suspense Account.” A “Cash Suspense Account” is defined by the Manual as “a temporary cash account opened at a Bank (other than a Bank being the Failed Participant) to which cash, stemming from the settlement of securities

750 CSD Rules 3.10.3.
751 In terms of the Manual a “corporate action is defined as an action taken by the Issuer or any third party, that results in changes to the capital structure or financial position of the Issuer of a security, that affects any of the securities issued by an Issuer, and which affects the Beneficial Owner of uncertificated securities in terms of an entitlement.” Strate Limited Participant Failure Manual 5.
752 In terms of the Manual a “capital event” refers to “a money market security corporate action.” Strate Limited Participant Failure Manual 4.
753 Ibid.
754 Ibid.
transactions or cash collateral in terms of securities lending returns and/or deposit of New-Cash, is posted.” This account will be used as the recipient of all re-routed cash proceeds from the settlement of sale transactions and cash collateral proceeds for securities lending returns, from the date after failure, in order to prevent the cash from being trapped in the failed bank. A “Corporate Action Suspense Account” is defined in the Manual as “a temporary cash account opened at a Bank (other than a Bank being the Failed Participant) to which cash, stemming from a Corporate Action or Capital Event, is posted.” This account will be used for all Corporate Action and Capital Event related payments.

It is important to note that the proposed re-routing of cash to a Cash Suspense Account or Corporate Action Suspense Account is currently not provided in any legislation. No provision is made for the opening of these accounts or for the re-routing of cash thereto. It is clear that the necessary legislate amendments will have to made. These amendments will depend on the support of the SARB as it will have to amend its Curator Guidelines in order to provide that a curator will be bound to re-route settlements resulting in cash to a Cash Suspense Account or Corporate Action Suspense Account. Currently, the curator’s only main duty is to conduct the management of the bank in such a manner as the Registrar may deem to best promote the interest of the creditors of the bank concerned and of the banking sector as a whole. The curator, therefore, is under no obligation to re-route settlements resulting in cash to a Cash Suspense Account or Corporate Action Suspense Account. In addition, the legal framework of Strate will also need to be amended to accommodate these types banks accounts, as there is currently nothing in its legal framework which supports such a proposal. Once the required support is obtained from the SARB a decision will also have to be taken as to which legal entity should hold the Suspense Accounts. The two options considered by Strate are that these

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756 Strate Limited Participant Failure Manual 35.
758 Strate Limited Participant Failure Manual 36.
759 Strate Limited Participant Failure Manual 34.
760 S 692(B)(a) of the Banks Act.
accounts will either be held in the name of a Nominee of the Failed Participant or in the name of a Nominee of Strate.\textsuperscript{761}

The big question remains whether the NPS Department of the SARB will support and permit the re-routing of cash as proposed by the Manual.\textsuperscript{762} The Manual assumes that the NPS Department will permit payments to be re-routed to and from the Failed Participant using the two cash suspense accounts.\textsuperscript{763} Currently, the NPS Act provides that that settlement is final and irrevocable and no settlement in terms of a settlement instruction which has been finally and irrevocably effected may be reversed or set aside.\textsuperscript{764} Accordingly, no re-routing of cash or the lifting of a commit on a transaction previously committed to by the Failed Participant is permissible.\textsuperscript{765} It is clear that this proposal of the Manual is a clear contradiction to the current position and workings of the NPS Department. At this stage, the decision of the NPS Department is still unknown. In the meantime, Strate will need to clarify if and how the possible lifting of a commit on a transaction will affect any previous legal obligations and whether it establishes a right of recourse to a client against the Failed Participant.

5.5 FUTURE DEVELOPMENTS

To date, no legislative changes have been published in order to support the recognition or implementation of the Manual into the legal framework pertaining to the financial market. Strate is also still awaiting formal acknowledgement of its role as Failure Manager by the FSB and SARB. Strate is, however, in the process of reviewing existing legislation and is proposing the necessary amendments. As noted

\textsuperscript{761} Strate Limited \textit{Participant Failure Manual} 35 & 123.
\textsuperscript{762} \textit{Ibid}.
\textsuperscript{763} Strate Limited \textit{Participant Failure Manual} 41.
\textsuperscript{764} S 5(3) and (4) of the NPS Act state the following:
\begin{itemize}
  \item "(2) A settlement that has been effected in money or by means of an entry to the credit of the account maintained by a settlement system participant in the Reserve Bank settlement system or a designated settlement system is final and irrevocable and may not be reversed or set aside.
  \item (3) An entry to or payment out of the account of a designated settlement system participant to settle a payment or settlement obligation in a designated settlement system is final and irrevocable and may not be reversed or set aside."
\end{itemize}
\textsuperscript{765} The issue of "commit" or "commitment" was discussed in paragraph 3.2 above.
above, the SSA is in the process of being amended and it is anticipated that the required amendment highlighted in this chapter will be included. At this stage it is also uncertain as to how the Manual will be incorporated into Strate’s existing legislative framework. Various possibilities exist, namely, it can be incorporated into the general rules of Strate or as an enabling provision. It can also be published as a directive to the Strate with the relevant regulators opting to be bound by the Manual.

5 6 CONCLUSION

In this Chapter, the meaning of Participant Failure was discussed. It was concluded that Participant Failure is limited to three events, namely curatorship, judicial management and liquidation. An overview of these events was given and the impact of the proposed provisions of the Manual on these three events was examined.

This examination was succeeded by an overview of the Participant Failure Manual and of utmost importance, the proposed impact of Participant Failure on securities settlement and the securities accounts examined and discussed. It was concluded that settlements on the date of failure will in fact occur and no failure actions will take place. At this stage, the Manual assumes that such settlement will be supported by the SARB, who will have the obligation of honoring the payment obligations of the Failed Participant on the date of failure. However, in this regard the issue of bail outs and moral hazard was raised. It is feared that, should the SARB, as lender of last resort, bail out banks every time they face a financial crisis it could lead to excessive risk taking and poor risk management by banks. It was submitted that, should the SARB undertake to honour these obligations, its legislative measures and principles will have to be amended to provide for these types of bail outs and the effective regulation and supervision thereof.

Settlements after date of failure will result in various procedures to be taken over by Strate, or its representative, as Failure Manager. These procedures include the transfer of securities from a Failed Participant to other Participants and the re-routing

\textsuperscript{766} Paragraph 2 4 2 above.
of cash proceeds from settled sale transactions, collateral and Corporate Actions / Capital Event related cash receipts.

This chapter highlighted the necessary legislative amendments and required endorsements from the relevant regulators as required by the Manual. These legislative amendments and endorsements included the following:

- the Registrar’s approval for the promulgation of Rules and appointment of Strate, or its representative, as Failure Manager must be obtained;

- the Curatorship Guidelines, the SSA, the Banks Act and the Insolvency Act will need to be amended in order to provide for the relationship between the curator and the Failure Manager as well as the role of the Failure Manager in relation to sections 46, 35A and 35B of the Insolvency Act;

- subsection s35A(2) of the Insolvency Act needs to be redrafted in order to clarify what the required procedure and timeline is in making the relevant election;

- the SSA will need to be amended in order to oblige a judicial manager (business rescue practitioner) to accept the Failure Manager’s role and follow the procedures proposed in the Manual;

- the relationship between the Failure Manager and the liquidator will have to be stipulated in amended legislation;

- Strate should obtain an endorsement and acknowledgement from the Master of the Court on the existence of the Manual and the appointment judicial manager or liquidator;

- the appointment and role of Strate, or its representative, as Failure Manager must be endorsed by both the FSB and SARB. It is expected that these
regulators will be required to promulgate Regulations in support of the Manual and to make the necessary amendments to the Curatorship guidelines;

- the CSD Rule will have to be amended to provide for the appointment of Strate, or its representative to act as Failure Manager. In this regard a decision must be taken on the possibility of interpreting or amending the current CSD Rules which provides for the appointment of an interim manager under conditions of imminent danger;

- the Strate Crisis Committee Plan will need to be amended to provide the constitution of the PFCC on notification;

- the line of reporting from the Failure Manager to the FSCF must be provided for in the FSCF Guidelines on failure management as well as in the Terms of Reference of the Strate Crisis Committee and Market Crisis Committee of the FSB;

- Strate will need to clarify and familiarise itself with the requirements of the FSCF with regards to media releases in order to ensure that the Strate Crisis Committee and the Market Crisis Committee of the FSC complies with these requirements should they become responsible for any media releases;

- Strate will need to extend the provisions of the line of reporting/escalation procedure to include the event where the failure of a Participant can lead to potential systemic risk;

- SARB will need to clarify whether its undertaking to “manage” the failure of a bank can in fact be interpreted to mean that it will provide the necessary liquidity on behalf of the failed bank;

- Strate will need to engage the SARB to ensure that the necessary amendments are made to the Curator Guidelines to provide for the opening and re-routing of cash to Cash Suspense Accounts or Corporate Action Suspense Accounts;
• Strate will need to clarify if and how the potential lifting of commit will affect any previous legal obligations and whether it only establishes a right of recourse of a client against the Failed Participant.

It is clear from the above that integration of the Manual into the current legal framework pertaining to the financial market raises various issues and requires extensive legislative amendments. However, this Manual can serve as an imperative crisis management tool in the alleviating or mitigating of systemic risk. The Manual was expected to come into force in the middle of 2010, but this was clearly not the case. Strate is currently still in the process of obtaining the necessary endorsements from the relevant regulators and recommending the necessary amendments to Parliament. Only time will tell if, how and when the Manual will be integrated into the legal framework pertaining to the financial market.
6.1 INTRODUCTION

In this chapter, a summary of the previous chapters will be presented, followed by a pertinent conclusion.

6.2.1 Chapter One

This chapter served as an introduction to the dissertation as it provided an explanation of the term financial market and its role in the economy. It also provided the problem statement, objectives, significance, limitations and an outline of the chapters of this dissertation. Lastly, it included a summary of the research methodology used.

The term “financial market” was defined as:

“institutions, infrastructures and procedures for the direct and indirect exchange of financial assets and risk exposures by a variety of economic agents.”

The role of the financial market was described to include price setting, avoiding regulatory arbitrage, raising capital, liquidity, investing and payment intermediation.

The problem statement was attributed to the need to examine and evaluate the legislative measures pertaining to the selected segments of the financial market to establish whether they are sufficiently robust to deal with a crisis such as the global economic meltdown.

The primary objective of this dissertation was to examine and evaluate the current legal framework pertaining to selected segments of the financial market and to
highlight any regulatory gaps which may have been found to exist. The secondary objectives of this dissertation were to:

- gain an understanding of the legal framework and by highlighting the gaps;

- highlight any regulatory uncertainties of gaps which could inform policy makers, who would be able to take note of such gaps; and

- where necessary, amend legislation or policy documents to overcome these gaps.

The significance of this study was attributed to the global economic meltdown. The global economic meltdown highlighted that certain tried and tested legislative measures emanating from the current South African legal framework may not be as effective as in previous economic environment. It was, therefore, necessary to take a fresh look at the regulatory framework of the selected segments of the South African financial market to evaluate the effectiveness and to indicate where improvements can be made.

The segments selected for the purposes of this dissertation included the capital market, the money market, the derivative market and the commodity market. The rationale behind the selection was that if one should have attempted to examine the legal framework of all the different segments of the financial market, the ambit to be covered could potentially have been too broad and this dissertation might not have been able to deal with all the segments comprehensively. The scope of this dissertation was, therefore, restricted to the domestic financial market. The foreign exchange market and insurance market were excluded from the ambit.

With regards to the research methodology, a qualitative approach was deemed appropriate. The main sources consisted of existing legislation, rules and regulations as well as literature, such as textbooks and articles. Overall the desktop methodology was used in this dissertation.
Chapter Two

This Chapter aimed to provide an overview of financial market selected terminology, the regulators and the current legal framework pertaining to the segments of the financial market selected for the purposes of this dissertation.

The chapter commenced with a discussion on selected financial market terminology. The selection of the terms was based on a diagram illustrating an overview of the role-players and financial instruments in the financial market. The terminology selected included the following terms: securities, issuer, certificated securities, uncertificated securities, central securities depository, central securities depository participant, unlisted securities, listed securities, exchange, authorised user, securities services, regulated person, self-regulatory organisation and client.

This was followed by an overview of the establishments and organisational structures of the respective regulators operating in the South African financial market. The discussion on the regulators included the SARB, FSB, Strate and JSE. The overview also included a discussion on the recent consolidation of the JSE and BESA.

Succeeding this was an overview of the current legal framework pertaining to the financial market. This overview was based on a diagram which illustrated the legislative foundation of the financial market. The legislative measures discussed included the SSA, the SARB Act, the NPS Act, the Banks Act, the Companies Act as well as the FSB Act. An overview of the various international institutions providing international best practice, to which South African is a member, followed. These institutions included IOSCO, G20, IMF, World Bank, UNIDROIT, Financial Stability Board and the BIS.

Finally, a discussion on the specific legal frameworks pertaining to the selected segments of the financial market followed. The first segment was the capital market. The capital market was defined as follows:

“a complex of institutions and mechanisms through which funds with terms of more than three years are pooled and made available to the private and public sectors.”
The discussion on the legal framework pertaining to the capital market included: the Securities Services Act, the CSD Rules and Directives, the Exchange Rules, the Exchange Directives, the Exchange Listing Requirements and the Exchange Guarantee Fund Rules.

The second segment was the money market. The money market was defined as the market where short-term securities are traded. The specific money market instruments were defined and discussed and included bankers’ acceptances, promissory notes, treasury bills, negotiable certificate of deposits, South African Reserve Bank debentures, Land Bank bills, commercial paper, repurchase agreements, bridging bonds, capital project bills, Transnet Limited coupon stocks and call bonds. The discussion on the legal framework pertaining to the money market included the recent developments in the money market, Chapter IV of the Securities Services Act, the CSD Rules and Directives as well as the South African Reserve Bank Operational Notice.

The last segment was the derivative market. The derivative market was defined as the market for derivative instruments. A derivative instrument was defined as:

“any financial instrument or contract that creates rights and obligations and that derives its value from the price or value, or the value of which may vary depending on a change in the price or value, of some other particular product or thing.”

The specific derivative instruments defined and discussed included Futures and Forwards, Swaps, Options and Warrants. The discussion on the legal framework pertaining to the derivative market included the Securities Services Act, CSD Rules and Directives, the Exchange Rules, the Exchange Directives and the JSE Ltd Fidelity Fund Rules.
This chapter aimed to provide an overview of the securities settlement process in South Africa. It also aimed to provide an examination of the impact of the recently promulgated Companies Act 71 of 2008 on securities settlement.

The chapter commenced with an overview of the securities settlement process as performed, regulated and supervised by Strate. This was followed by the examination of the impact of the new Companies Act, 2008 on securities settlement in South Africa. To this end, an extensive gap analysis between the Companies Act, 1973 and the Companies Act, 2008 was completed in order to highlight the differences between these two Acts. The focus of this examination fell on the specific provisions of the two Acts dealing with the registration and transfer of uncertificated securities. This examination also included the amendments as contained in the Companies Amendment Bill [B40 - 2010] published on 10 November 2010.

The gap analysis revealed the scope of the impact of the Companies Act, 2008 to be the following:

- the Companies Act, 2008 does not refer to a company’s register of members, but to a company’s securities register. Accordingly, all references to a company’s register of members in terms of the Companies Act, 1973 will be substituted with references to a company’s securities register;

- unlike the Companies Act, 1973, which defines “certificated securities” with reference to the SSA, the Companies Act, 2008 contains no such reference. It merely states that for purposes of the Act, “certificated” means “evidenced by a certificate”;

- the Companies Act, 2008 does not utilise the term “subregister”, but the term “uncertificated securities register.” In terms of the Companies Act, 2008, this term is defined as “the record of uncertificated securities administered and maintained by a participant or central securities depository, as determined in
accordance with the rules of a central securities depository, and which forms part of the relevant company’s securities register established and maintained in terms of Part E of Chapter 2.” The SSA currently makes reference to and defines a subregister in terms of section 91A(1) of the Companies Act, 1973. Accordingly, this definition will have to be amended to reflect the term “uncertificated securities register” and its attributed definition as contained in the Companies Act, 2008;

- section 53 of the Companies Act, 2008 provides that the transfer of ownership of uncertificated securities occurs despite any fraud, illegality or insolvency. The ground of insolvency were not contained in the Companies Act, 1973 and accordingly, in future, settlement of securities will take place despite insolvency;

- unlike section 91A(5) of the Companies Act, 1973, section 53 includes the role and the rules of a CSD in conjunction with the role of a CSD Participant;

- section 53(3) of the Companies Act, 2008 contains an additional provision in that it provides that section 51(5) of the Companies Act, 2008 applies to the transfer of ownership of uncertificated securities. Section 51(5) sets out the details a company must enter into its securities register concerning every transfer of uncertificated securities;

- Sections 91A(4)(b), 91A(4)(d), 91A(4)(e) and section 91A(6) of the Companies Act, 1973 were not included in the Companies Act, 2008;

- the provisions contained in section 50(3)(b)(ii) and section 52(2)(b) of the Companies Act, 2008 are additional. Section 50(3)(b)(ii) provides that the CSD Rules may also prescribe certain details which must be contained in the securities register to be established and maintained by a CSD or a CSD Participant in respect of the uncertificated securities held by them. Section 52(2)(b) provides that the inspection of uncertificated securities registers must be done, not only in accordance with the Companies Act, but with the CSD Rules as well;
sections 50(4) and 50(5) of the Companies Act, 2008 are additional. Section 50(4) provides that a securities register, or an uncertificated securities register, maintained, in accordance with the Companies Act, 2008, is sufficient proof of the facts recorded in it in the absence of evidence to the contrary. Section 50(5) provides that “unless all the shares of a company rank equally for all purposes, the company’s shares, or each class of shares, and any other securities, must be distinguished by an appropriate numbering system;”

section 52(3) Companies Act, 2008 allows “five business days” from the date of request within which to produce the uncertificated securities register (obtained from the CSD or CSD Participant) for inspection. Section 91A(e)(ii) allows “seven days.” The difference between “business days” and “days” lies in the method of computation of time periods. When reference it made to “business days”, the first day is excluded, the last day is included and Saturdays, Sundays and public holidays are also excluded. However, when reference is made to “days”, it includes all the normal calendar days (which include Saturdays and Sundays and public holidays);

there is no corresponding section contained in the Companies Act, 2008 to the provision in section 91A(3)(b) of the Companies Act, 1973, which provides that “no name of any person for whom a participant holds uncertificated securities as nominee shall form part of the subregister.” Hence, it can be concluded that, in the future, the names of such nominees will be included for the purposes of the securities register of a company;

section 91A(10) of the Companies Act, 1973 which provides an offeree with a choice between certificated or uncertificated securities at such time that the securities are offered to him/her by the company concerned, is not included in the Companies Act, 2008;

unlike section 91A(7) of the Companies Act, 1973, section 54 of the Companies Act, 2008 includes the role and the rules of a CSD in conjunction with the role of a CSD Participant;
- section 91A(7)(b)(i) of the Companies Act, 1973 provides a CSD or CSD Participant with seven days, after the receipt of a notice to convert certificated securities into uncertificated securities, to notify the relevant company and remove such details from its uncertificated securities register. The corresponding section in 54(1) the Companies Act, 2008 provides for five business days;

- section 91A(7)(b)(iii) of the Companies Act, 1973 provides a company with 14 days within which to prepare the securities certificate and to notify the CSD that the securities are no longer held in certificated form. The corresponding section in section 54(2)(b) of the Companies Act, 2008 provides for 10 business days;

- section 54(2)(b) of the Companies Act, 2008 grants companies ―20 business days in the case of holders of securities not resident within the Republic‖ to comply with section 54(2)(b). These 20 additional business days provided to non-residents of the Republic were not previously provided for in the Companies Act, 1973 and are, therefore, additional to the Companies Act, 2008;

- section 54(3) of the Companies Act, 2008 which entitles a company to elect to charge a fee to the holder of the securities who converts their securities from certificated to uncertificated form is an additional provision;

- section 91A(7)(b)(iv) of the Companies Act, 1973 was not included in the Companies Act, 2008;

- unlike the Companies Act, 1973, sections 55(2) and 55(3) of the Companies Act, 2008 include the roles and rules of a CSD in conjunction with the role of a CSD Participant. Two additional grounds for liability are also provided for in section 55(3)(b). This section provides that a CSD Participant or CSD may be held liable to indemnify any other person who suffers any direct loss or damage as a result of the transfer of uncertificated securities in accordance with an instruction that was not sent and properly authenticated, or a manner
inconsistent with an instruction that was sent and properly authenticated in terms of the CSD Rules;

- no corresponding provision to section 91A(12) of the Companies Act, 1973, which provides for the offences and related liabilities which arise from the contraventions specified in sections 91A(5)(a) and 91A(8) of the Companies Act, 1973, was included in the Companies Act, 2008. Chapter 9 of the Companies Act, 2008 which deals with offences and penalties also makes no specific reference to offences and liabilities arising from the registration and transfer of uncertificated securities;

- the additions to the Draft Regulations to the Companies Act, 2008 deal with:
  (a) the details which must be contained in the securities register of a profit company as required in terms of section 50(2)(b); (b) the details which must be entered into a company’s securities register on receipt of any disclosures of beneficial interests; (c) the manner in which a securities register must be kept; (d) the requirements for a company’s securities register which is held in electronic form; (e) the disposal of entries in a securities register where a person has ceased to hold securities in the company after seven years; and (f) the acquisition and loss of shareholder rights in securities held by shareholders;

- unlike its corresponding provisions in the Companies Act, 1973, section 56(1) of the Companies Act, 2008 provides that a company may state in its Memorandum of Incorporation that securities issued by the company may not be held by one person for the beneficial interests of another. This modification is of great significance as it places a limitation on the scope of beneficial interests in the companies’ environment;

- the definition of “beneficial interest” is amended in the Companies Act, 2008 to the following effect. Firstly, unlike section 140A(1), the definition contained in the Companies Act, 2008 specifies the ways through which a beneficial interest in a security can be obtained. Secondly, section 140A(1)(a) refers to “the right of entitlement to receive any dividend or interest payable in respect of
that security,” whereas section 56(1)(a) refers to the right or entitlement to “receive or participate in any distribution in respect of the company’s securities.” Thirdly, whereas section 140A(1)(b) specifically mentions certain rights, such as voting, conversion and redemption rights, section 56(1)(b) does not mention any specific rights. It merely contains a general provision referring to “any or all of the rights.” In the fourth instance, section 56(1)(c) contains an additional right not included in the Companies Act, 1973, being the right to “dispose or direct the disposition of the company’s securities, or any part of a distribution in respect of the securities.” Lastly, the Companies Act, 1973 makes reference to the now repealed Unit Trusts Control Act and accordingly, the Companies Act, 2008 makes reference to its successor, the Collective Investment Schemes Act;

- section 140A of the Companies Act, 1973, defines the terms “exchange” and “security” with reference to the now repealed SECA and the FMCA. Section 1 of the Companies Act, 2008 defined both these terms with reference to their meanings as set out in the SSA;

- the Companies Act, 2008 not only denotes to the term “securities” the meaning set out in section 1 of the SSA, but in addition also includes the shares held in a private company. It is clear that that shares held in a private company were specifically included in the definition of securities for purposes of the Companies Act, 2008;

- section 56(2) of the Companies Act, 2008 implies that a beneficial security can only be held in respect of a security of a “public company.” Accordingly, it was submitted that a beneficial security cannot be held in respect of a security issued by a non-profit company;

- section 140A(2) refers to a “body corporate or trust”, whereas section 56 (2) of the Companies Act, 2008 refers to a “juristic person.” In terms of the Companies Act, 2008 a “juristic person” includes a foreign company and a trust, irrespective of whether or not it was established within or outside the Republic. It is clear that by referring to the broader concept of “juristic person,” rather than
just a body corporate or trust, the legislature intended to widen the application of section 56 of the Companies Act, 2008;

- section 140A(3) of the Companies Act, 1973 refers to securities “of an issuer” whereas section 56(3) refers to “a security of a public company.” This was noted to be in line with an earlier statement that a beneficial interest can only be held in respect of securities issued by public companies;

- section 140A(4) of the Companies Act, 1973 requires that the information to be disclosed in terms of section 140A(3) be furnished within seven days of the end of a three month period. Section 56(4) of the Companies Act, 2008 requires this information to be disclosed within five business day after the end of every month during which a change has occurred. The words “during which a change has occurred” was inserted by the Companies Amendment Bill, 2010. It was submitted that this was done in order to restrict this obligation of disclosure to the event where such disclosure has an impact or is relevant to the other parties or entities involved;

- section 56(4) of the Companies Act, 2008 contains an additional provision not contained in the Companies Act, 1973. This section provides for the disclosures of prescribed information by registered holders of securities at times other than within five days after the end of every month, subject to payment of a prescribed fee to such registered holders of securities;

- unlike section 140A(7) of the Companies Act, 1973, which allows for 14 days within which to furnish the prescribed information after receipt of the notice, section 56(6) of the Companies Act, 2008 allows for 10 business days;

- section 56(7) of the Companies Act, 2008 provides that the obligations specified in subsections (7)(a) and (7)(b) apply only to regulated companies which fall within the definition of “regulated company” as provided for in section 117 (1)(i) of the Companies Act, 2008. This is not a requirement in terms of section
140A(8) of the Companies Act, 1973, as it provides that “all issuers” of securities are under such obligation;

- section 56(7) of the Companies Act, 2008 provides that regulated companies, who are required to publish financial statements and which must be audited in terms of section 30(2), must publish other additional information in their annual financial statements. This information includes a “list of the persons who hold beneficial interests equal to or in excess of 5% of the total number of securities of that class issued by the company, together with the extent of those beneficial interests” in such annual financial statements;

- no equivalent to section 140(8)(b) of the Companies Act, 1973 was included in the Companies Act, 2008;

- the additional provisions introduced by the Companies Amendment Bill regulates voting rights by persons who hold beneficial interests in securities and their appointed proxies. The provisions set out two voting requirements, namely, that the beneficial interest must include the right to vote and that the relevant holder’s name or his/her proxy must have been entered into the company’s register of disclosure. These provisions also afford holders of beneficial interest in securities the right to demand a proxy appointment from the registered holders of those securities. This demand must be delivered in writing or as required in terms of the CSD Rules. It is important to note that the registered holders of securities must notify the relevant holders of beneficial interests of any meetings in which such persons are entitled to vote and if so demanded, deliver a proxy appointment as well. It is also important to note that these provisions will not apply in the circumstances where the CSD Rules apply.

624 Chapter Four

This chapter aimed to provide a background to the global economic meltdown. It also aimed to discuss certain selected issues highlighted by the global economic meltdown and examine how they are currently regulated in legal framework
pertaining to the financial market. Lastly, this chapter aimed to make recommendations on regulatory reform where legislative gaps were highlighted.

The chapter commenced with a background to the global economic meltdown. This was followed by a discussion on certain selected issues highlighted by the global economic meltdown and an examination of how they are currently regulated in legal framework pertaining to the financial market. This examination included recommendations on regulatory reform where legislative gaps were highlighted. The recommendations were based on an evaluation of the legislative measures proposed and taken by institutions providing international best practice. The selected issues were credit rating agencies, investor due diligence, crisis management tools, compensation structures, accounting and valuations standards, issuer transparency, market transparency and risk management.

The first issue discussed and examined was CRAs.

- CRAs are currently self-regulated in South Africa. The extent of this self-regulation entails compliance with the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies as well as the IOSCO Objectives and Principles of Securities Regulation;

- it has been argued by BANKSETA that the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies is in effect unenforceable in South Africa as there is no designated institution or regulator responsible for the enforcement or monitoring of this compliance. It has also argued that some of the provisions of the Code of Conduct Fundamentals for Credit Rating Agencies may not even be relevant to South Africa;

- enacting new legislation regulating the conduct of CRAs may be costly and has the potential to exclude South Africa from other foreign markets if it is not aligned with international best practice;
a Credit Rating Services Bill is currently being prepared by the National Treasury. It was submitted that the focus of this Bill should fall on the *IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, IOSCO Objectives and Principles of Securities Regulation*, the Financial Stability Board’s *Principles for Reducing Reliance on CRA Ratings* and the specific issues highlighted by the global economic meltdown. These issues include the role of CRAs, dealing with conflicts of interest, ensuring transparency of ratings and methodology as well as improving quality of ratings.

The second issue discussed and examined was investor due diligence.

- there are currently no legislative measures regulating investor due diligence in South Africa;

- it was suggested that investor due diligence procedures should clearly be listed, e.g. a code of conduct, in order for investors to be attentive of what is expected of them and what measures they can take in order to protect themselves from market risks. Non-compliance by investors should be made subject to liabilities and/or sanctions;

- it was submitted that the IOSCO *Good Practices in Relation to Investment Managers’ Due Diligence When Investing in Structured Finance Instruments* may serve as a useful foundation in drafting such a code of conduct;

- it was also suggested that the proposed code of conduct be drafted in conjunction with the Credit Rating Services Bill as there seems to be a link between CRAs and the notion of investor due diligence.

The third issue discussed and examined was crisis management tools.

- the SARB has committed itself globally to address cross-border resolutions and systemically important financial institutions by the end of 2010. To date, nothing has been published in this regard. The SARB has, however, indicated
that it will continue to engage with the Financial Stability Board and its work on the implementation of the Financial Stability Board’s *Principles for Cross-border Co-operation on Crisis Management* is ongoing;

- the SARB has also undertaken to establish crisis management groups for the major cross-border firms as well as a legal framework for crisis intervention;

- Strate is currently in the process of drafting a Participant Failure Manual. This Manual aims to regulate Participant Failure in a manner which alleviates or mitigates systemic risks and which is the least disruptive to the financial system. It was submitted that this Manual would serve as a significant crisis management tool should it be incorporated into the legal framework pertaining to the financial market.

The fourth issue discussed and examined was compensation structures.

- there are currently no legislative measures regulating compensation structures in South Africa. It was suggested that specific national legislation to this effect be drafted. Guidance for these legislative measures can be obtained from the JSE’s current compensation philosophy;

- it was submitted that compensation structures should be structured in a fair and reasonable manner and the factors to be taken into account should include the size and role of the specific entity in the South African financial sector, the nature of the entity’s business, its risk profile, the competitive environment, capital requirements, financial affordability and recognising individual contributions and collective results. There should also be a clear differentiation of employees based on responsibility, competencies and scarcity of skills;

- it is expected that the *FSF Principles for Sound Compensation Practices* will be incorporated into the legal framework pertaining to the financial market. It was recommended that, in the interim, a similar methodology to that of the BIS
for assessing compliance with these principles be used. This methodology will also be able to serve as a good foundation for subsequent legislation.

The fifth issue discussed and examined was accounting standards.

- the SSA requires regulated persons to conform to GAAP. Supplementary to the SSA is the SSA Board Notice on Accounting Records to be Maintained by a Regulated Person. This Notice sets out the specific accounting records which must be maintained by regulated persons, an exchange, a CSD, a clearing house, authorised users and CSD Participants;

- in compliance with the SSA, the JSE Listing Requirements and the BESA Listing Disclosure Requirements require compliance with the South African Statements of Generally Accepted Accounting Practice, which in turn, have now been fully aligned with IFSR;

- it was submitted that the South African legal framework will have to be revised when the new international accounting standards are published in 2011. These international accounting standards are currently being drafted on the recommendations from the G20 and the BCBS;

- it was suggested that specific national legislation regulating compliance of all regulators and financial institutions with SA GAAP and IFRS be enacted in order to provide a more uniform legal framework in this regard.

The sixth issue discussed and examined was issuer transparency.

- it was submitted that the JSE Equities Rules, JSE Listing Requirements and BESA Listing Disclosure Requirements sufficiently regulate issuer transparency;

- it was suggested that the BESA Rules be amended, in line with the JSE Equities Rules, to require issuers to disclose certain information regarding
securities after it has been listed. It was submitted that the new Listing Requirements consolidating the JSE Listing Requirements and the BESA Listing Disclosure Requirements should be used as an opportunity to remedy the deficiencies of the BESA Rules in this regard;

- it was noted that the FSB has published a *General Code of Conduct for Authorised Financial Services Providers and Representatives* to ensure that the clients being rendered financial services will be able to make informed decisions;

- it was also noted that the Consumer Protection Act 68 of 2008 was recently promulgated and will come into force on 1 April 2011. This Act strives to protect consumers by providing them with adequate disclosure of standardised information in order to make informed choices. It was submitted that any further discussions on consumer protection would have been too wide for purposes of this dissertation;

- it was submitted that the *IOSCO Objectives and Principles of Securities Regulation* and the additional recommendations made by IOSCO can serve as a good guideline to policy makers in amending the current deficiencies in the legal framework pertaining to the financial market. Issuers should be required to disclose all material information regarding the financial instruments concerned so as to ensure that investors are protected from making uninformed decisions regarding financial instruments and liabilities. Sanctions for non-compliance by issuers should be imposed.

The seventh issue discussed and examined was market transparency.

- it was submitted that both the JSE Equities Rules and BESA Rules sufficiently regulates market transparency;

- it was, however, suggested that a secondary market trade reporting system, as recommended by IOSCO, be developed so that the public is provided with
more prominent information regarding the frequency with which a given security trades and also latest data on the those trades.

The last issue discussed and examined was risk management.

- it was submitted that all the regulators have legislative measures or committees in place to regulate and ensure adequate risk management.
  - in compliance with the SSA, the JSE Equities Rules, JSE Derivative Rules, Yield X Rules, JSE Equities Directives and BESA Rules all contain legislative measures pertaining to the regulation of internal resources and risk management;
  - the SARB has a Risk Management Policy to ensure that risk management is performed in a coordinated, comprehensive and systematic manner that is consistent with internationally accepted standards and guidelines.
  - the FSB has established an Audit Risk Management Committee to, *inter alia*, advise the FSB on the adequacy of risk management processes and strategies. It is the responsibility of this Committee to ensure that identified risks are monitored and appropriate measures are put in place and implemented to manage such risks;
  - Strate has established an ERM Division which is responsible for its risk management function. This division effectively co-ordinates and manages the overall risk management program for Strate by assisting each division within the company to identify, assess and measure risks according to the probability of occurrence and the potential impact that the identified risk may have;
  - the Companies Act, 2008 requires an audit committee of a company to “perform other functions determined by the board, including the development and implementation of a policy and plan for a systematic,
disciplined approach to evaluate and improve the effectiveness of risk
management, control, and governance processes within the company.”

- it was noted that one would expect the BIS’s revised rules and
recommendations on risk management to be incorporated into the legal
framework pertaining to the financial market once it has been finalised.

6 2 5 Chapter Five

This Chapter aimed to discuss the meaning of Participant Failure and to provide an
overview of the Participant Failure Manual. More importantly, it aimed to discuss the
impact of Participant Failure on securities settlement, as proposed by the Manual.

The chapter commenced with the meaning of the term “Participant Failure.” It was
concluded this term is limited to three events, namely, curatorship, judicial
management and liquidation. An overview was given of what exactly these events
entail and the impact of the provisions of the Manual on these three events was
examined.

This examination was followed by an overview of the currently published Manual. Of
utmost importance was the Manual’s proposed regulation and impact of Participant
Failure on securities settlement and the securities accounts held by a Failed
Participant. It was concluded that settlements on the date of failure will in fact occur
and no failure actions will take place. At this stage, the Manual assumes that such
settlement will be supported by the SARB, who will have the obligation of honoring
the payment obligations of the Failed Participant on the date of failure. However, in
this regard the issue of moral hazard was raised. It is feared that, should the SARB,
as lender of last resort, bail out banks every time they face a financial crisis it could
lead to excessive risk taking and poor risk management by banks. It was submitted
that, should the SARB undertake to honour these obligations, its legislative measure
and principles will have to be amended to provide for these types of bail outs and the
effective regulation and supervision thereof. It was also concluded that settlements,
after date of failure, will result in various procedures to taken by the Strate, or its
representative, as Failure Manager. These procedures include the transfer of
securities from a Failed Participant to other Participants and the re-routing of cash proceeds from settled sale transactions, collateral and Corporate Actions / Capital Event related cash receipts.

In this chapter it was highlighted that a significant amount of endorsements by the relevant regulators and the Master of the Court as well as necessary amendments to existing legislation are required for the successful integration of the Manual into the legal framework pertaining to the financial market. These endorsements and legislative amendments included the following:

- the Registrar’s approval for the promulgation of Rules and appointment of Strate, or its representative, as Failure Manager must be obtained;

- the Curatorship Guidelines, the SSA, the Banks Act and the Insolvency Act will need to be amended in order to provide for the relationship between the curator and the Failure Manager as well as the role of the Failure Manager in relation to sections 46, 35A and 35B of the Insolvency Act;

- subsection s35A(2) of the Insolvency Act needs to be redrafted in order to clarify what the required procedure and timeline is in making the relevant election;

- the SSA will need to be amended in order to oblige a judicial manager (business rescue practitioner) to accept the Failure Manager’s role and follow the procedures proposed in the Manual;

- the relationship between the Failure Manager and the liquidator will have to be stipulated in amended legislation;

- Strate should obtain an endorsement and acknowledgement from the Master of the court on the existence of the Manual and the appointment judicial manager or liquidator;
• the appointment and role of Strate, or its representative, as Failure Manager must be endorsed by both the FSB and SARB. It is expected that these regulators will be required to promulgate Regulations in support of the Manual and to make the necessary amendments to the Curatorship guidelines;

• the CSD Rule will have to be amended to provide for the appointment of Strate, or its representative to act as Failure Manager. In this regard a decision must be taken on the possibility of interpreting or amending the current CSD Rules which provides for the appointment of an interim manager under conditions of imminent danger;

• the Strate Crisis Committee Plan will need to be amended to provide the constitution of the PFCC on notification;

• the line of reporting from the Failure Manager to the FSCF must be provided for in the FSCF Guidelines on failure management as well as in the Terms of Reference of the Strate Crisis Committee and Market Crisis Committee of the FSB;

• Strate will need to clarify and familiarise itself with the requirements of the FSCF with regards to media releases in order to ensure that the Strate Crisis Committee and the Market Crisis Committee of the FSC complies with these requirements should they become responsible for any media releases;

• Strate will need to extend the provisions of the line of reporting/escalation procedure to include the event where the failure of a Participant can lead to potential systemic risk;

• SARB will need to clarify whether its undertaking to “manage” the failure of a bank can in fact be interpreted to mean that it will provide the necessary liquidity on behalf of the failed bank;
• Strate will need to engage the SARB to ensure that the necessary amendments are made to the Curator Guidelines to provide for the opening and re-routing of cash to Cash Suspense Accounts or Corporate Action Suspense Accounts;

• Strate will need to clarify if and how the potential lifting of commit will affect any previous legal obligations and whether it only establishes a right of recourse of a client against the Failed Participant.

It became evident in this Chapter that the integration of the Manual into the current legal framework pertaining to the financial market raises various concerns and requires extensive legislative amendments and endorsements. However, this Manual can serve as an imperative crisis management tool in the alleviating or mitigating of systemic risk. Strate is still currently in the process of obtaining the necessary endorsements from the relevant regulators and recommending the necessary amendments to Parliament. If and when this notion will be accepted and how it will be regulated by the relevant regulators, without creating a conflict of interest, remains a question to be answered.

6.3 CONCLUSION

This dissertation suggested that the Companies Act 71 of 2008 will have a significant impact on securities settlement. It is recommended that companies, holders of uncertificated securities and holders of beneficial interests in uncertificated securities familiarise themselves with their revised rights and obligations in order to, amongst other things, ensure compliance with this new legislative framework.

This dissertation revealed that, even though our financial system has been found to be fundamentally sound and thus far have dealt with the global economic meltdown quite well, legislative reform to conform to international best practice is imperative. It is recommended that policy makers should strive to ensure that the South African legal framework pertaining to the financial market is sufficiently aligned with the principles, methodologies and recommendations as provided for by the international institutions providing best practice. The highlighted areas of legislative reform include the legal framework pertaining to credit rating agencies, investor due diligence, tools
for crisis management, compensation structures, accounting and valuations standards, issuer transparency, market transparency and risk management.

This dissertation highlighted that a significant amount of legislative amendments and endorsements by the relevant regulators and the Master of the Court are required for the successful integration of the Participant Failure Manual into the legal framework pertaining to the financial market. If, when and how the notion of Participant Failure will be accepted and regulated by the relevant regulators, without creating a conflict of interest, remains a question to be answered.

In conclusion, this dissertation revealed the need for a sound and robust legal framework in South Africa.

"Financial stability requires a robust financial system with the capacity to prevent or withstand shocks originating domestically or internationally. Such a system needs a sound regulatory environment, effective macro-prudential surveillance and public confidence."

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ABBREVIATIONS AND GLOSSARY

A

AltX

Alternative Exchange

Authorised User

A person authorised by an exchange in terms of the exchange rules to perform such securities services as the exchange rules may permit

B

BDA

Broker Deal Accounting

BESA

Bond Exchange of South Africa

BIS

Bank for International Settlements

BSD

Bank Supervision Department

BTA

Bond Traders Association
Bank for International Settlements
an international organisation which fosters international monetary and financial cooperation and serves as a bank for central banks

Bank Participant
an entity who is accepted as a Participant by Strate and who is also licensed as a bank under the Banks Act and whose bank activities are regulated by the BSD of the SARB

Bank Supervision Department
a department of SARB which is responsible for bank regulation and supervision

Bankers’ acceptance
a tradable short-term debt instrument formally defined as a bill of exchange drawn on and accepted by a bank

Bill of exchange
an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to a specified person or his order, or to bearer

Bond
a debt instrument that promises that the issuer will pay the holder interest over a certain period of time and repay the face value at maturity

Bond Exchange of South Africa
An exchange responsible for operating and regulating the debt securities and interest-rate derivatives markets in South Africa

Bond market
the market where debt instruments with maturities of longer than one year trade
**Bond Traders Association**

an association representing and promoting the interests of the BTA members in their relations with the bond market's regulatory authority, BESA, and which promotes good relations between its members

**Bridging bonds**

short-term unsecured security issued by public and semi-public sector bodies to acquire bridging finance

**Broker**

a trading party, who trades in the security market either for itself or for its clients

**Broker Deal Accounting**

the JSE system which keeps the securities records and books of individual broking firms in respect of their clients

**Business day**

excluding the first day, including the last day and excluding Saturdays, Sundays and public holidays

**Business partner**

an entity which is not a Participant and which interfaces with the CSD to perform an essential market function in the issue, investment and settlement of money market securities

**CASA**

Custody and Administration of Securities Act
CBRG
Cross-border Bank Resolution Group

CMD
Capital Markets Department

CRA
Credit Rating Agency

CSD
Central Securities Depository

CSDP
Central Securities Depository Participant

Calendar days
include Saturdays and Sundays and public holidays

Call bonds
negotiable short-term commercial paper issued by large corporations

Capital Event
a money market security “corporate action”

Capital market
complex of institutions and mechanisms through which funds with terms of more than three years are pooled and made available to the private and public sectors

Capital Markets Department
a department of the SARB which regulates the capital markets in South Africa in terms of the SSA
Capital project bills

short-term securities issued by large companies or public corporations to raise funds for the maintenance of capital projects

Cash Suspense Account

a temporary cash account opened at a Bank (other than a Bank being the Failed Participant) to which cash, stemming from the settlement of securities transactions or cash collateral in terms of securities lending returns and/or deposit of New-Cash, is posted

Central Securities Depository

a person who is licensed as a central securities depository in accordance with the SSA

Certificated securities

securities evidenced by a certificate or written instrument

Clearing

The process, in conjunction with settlement, of determining accountability for the exchange of money and Securities between counterparties to a transaction.

Clearing Bank

a bank that is regulated by the Registrar of Banks and is permitted to clear and settle cash. It is a settlement system participant and a member of the payment Association of South Africa (PASA) as required by the National Payments System Act 1998.

Client

any person who uses the services of an authorised user or a participant, as the case may be
Commercial paper

short-or medium-term securities issued by corporate and other non-banking institutions to acquire working capital

Commitment

An electronic instruction that constitutes an undertaking by a Participant to settle a transaction in uncertificated Securities on Settlement Date

Commodities

corn, grain, oils, maize and precious metals such as gold (bullion) and platinum

Commodity market

the market where commodities are traded

Contractual settlement

a client has a contractual obligation to ensure that a trade concluded on the JSE settles on settlement day although the settlement obligation still resides with the trading member.

Corporate Action

an action taken by the Issuer or any third party, that results in changes to the capital structure or financial position of the Issuer of a security, that affects any of the securities issued by an Issuer, and which affects the Beneficial Owner of uncertificated securities in terms of an entitlement

Corporate Actions Suspense Account

a temporary cash account opened at a Bank (other than a Bank being the Failed Participant) to which cash, stemming from a Corporate Action or Capital Event, is posted
Corporate Participant

a Participant who opens and maintains securities accounts only for securities owned by it

Credit swap

relates to credit default swaps and total return swaps

Credit default swap

a swap which entails that a fee is paid by the buyer to the seller in relation to protection from a credit default event

D

DTA

Derivatives Traders’ Association

Dematerialisation

The elimination of physical certificates or documents of title which represent the ownership of securities so that the securities exist only as electronic records

Derivative market

the market for derivative instruments

Derivative instruments

any financial instrument or contract that creates rights and obligations and that derives its value from the price or value, or the value of which may vary depending on a change in the price or value, of some other particular product or thing

Derivatives Traders’ Association

an association which represents the views and interests of the user firms registered to trade BESA-listed derivative instruments
Eligible securities

uncertificated securities or immobilised securities which the controlling body permits to be held in a central securities account, or in the case of money market securities, to be held in the securities ownership register

Equity

a financial instrument representing part ownership in a corporate entity

Equity market

the market where listed ordinary shares trade

Exchange

a person who constitutes, maintains and provides an infrastructure:

a) for bringing together buyers and sellers of securities;

b) for matching the orders for securities of multiple buyers and sellers; and

c) whereby a matched order for securities constitutes a transaction

Exchange Rules

Rules made by an exchange in accordance with the SSA

FAIS

Financial Advisory and Intermediary Services

FAIS DIVISION

Financial Advisory and Intermediary Services Division
Face value

The same as nominal value and can either be a present value or a future value

Failure Manager

a Strate representative or representatives who oversee the securities operations of a Failed Participant on behalf of the curator, liquidator or judicial manager

Financial instrument

a claim against a person or institution for the payment of a future sum of money and/or periodic payment of money

Financial market

institutions, infrastructures and procedures for the direct and indirect exchange of financial assets and risk exposures by a variety of economic agents
Financial Markets Advisory Board

A department of the SARB which on its own initiative and at the request of the Minister or the registrar, investigate and report or advise on, administrative and technical matters concerning regulated persons or the provision of securities services

Financial Markets Department

A department of the SARB which performs international banking and international treasury services, implements the Reserve Bank’s interest rate policy, acts as funding agent of the government, facilitates the effective functioning of the domestic financial markets and manages the SARB’s gold and foreign exchange reserves.

Financial Services Board

A separate government agency overseeing the South African Non-Banking Financial Services Industry in the public interest and which sets the regulatory framework as well as the minimum standards and practices for market participants

Financial Service provider

Any person, other than a representative, who as a regular feature of the business of such person furnishes advice, furnishes advice and renders any intermediary service or renders an intermediary service

Financial Stability Board

An international institution which addresses vulnerabilities and develops and implements strong regulatory, supervisory and other policies in the interest of financial stability

Foreign exchange market

The market that determines the price of a currency relative to that of another country’s currency

Foreign exchange swap

A swap that requires the parties to physically exchange principal amounts of two currencies at the beginning of the swap’s life, with are-exchange of these amounts at
the end, including an adjustment to reflect the interest rate differential of the two currencies concerned.

**Formal market**

the market which provides for the trading of securities listed on an exchange

**Forward**

an OTC-traded contract to buy or sell a precise quantity of a certain underlying commodity at a precise price, place and time in the future

**Full Participant**

a Participant who opens and maintains securities accounts on behalf of Clients

**Future**

an exchange-traded contract to buy or sell a precise quantity of a certain underlying commodity at a precise price, place and time in the future

**G**

**G20**

Group of Twenty

**Group of Twenty**

an informal forum established to bring together systemically important industrialised and developing economies to discuss key issues in the global economy

**H**

**Hedging**

action taken to protect against the risk of an adverse outcome
IABS
International Accounting Standards Board

IBRD
International Bank for Reconstruction and Development

IDA
International Development Association

IFRS
International Financial Reporting Standards

IMF
International Monetary Fund

IOSCO
International Organisation of Securities Commissions

ISDA
International Swaps and Derivatives Association Master Agreement

Immobilisation

the placement of physical certificates for securities and financial instruments in a central securities depository so that subsequent transfers can be made by book entry, that is, by debits from and credit to holders’ accounts at the depository

InfoWiz

a system introduced by the JSE to provide a world-class information dissemination system and substantially improve the distribution of real-time equities market information
Interest rate swap

an agreement between two parties to settle the net difference between two interest rate payments on a notional amount of money, with one party agreeing to pay a fixed rate of interest and the other a floating rate

International Monetary Fund

an international organisation which provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty

International Organisation of Securities Commissions

an international association of securities regulators

International Swaps and Derivatives Association

an international association which aim is to encourage the prudent and efficient development of privately negotiated derivatives

Issuer

issuer of securities and, in Chapter IV of the SSA, includes an issuer of money market instrument

J

JET

Johannesburg Equities Trading

JSE

JSE Limited
**Johannesburg Equities Trading System**

the trading system run by the JSE to match buy and sell orders of JSE member firms automatically

**JSE Member**

an equities member, which is a category of authorised user admitted to membership of the JSE under the JSE Equities Rules

**Johannesburg Securities Exchange Limited**

The single exchange in South Africa for trading of listed securities

**JSE Settlement Authority**

person or persons appointed by the JSE to manage the settlement of transactions in bonds effected through the Yield-X trading system in terms of the Yield-X Rules and Directives and the Strate Rules and Directives

**Land Bank Bill**

a short-term discount security issued by the Land and Agricultural Bank of South Africa

**Liquidity**

the ease with which an instrument can be readily disposed of at prevailing market prices

**Listed securities**

securities included in the list of securities kept by an exchange in accordance with the SSA
M

MBS
Mortgage-backed securities

Market Participant
an authorised user, a participant, a client or a settling party as defined in s 1 of the SSA or any other party to a transaction

Market price
a price that is set by market makers who quote both buying and selling prices for an asset or financial instrument

Matching
the process for comparing the trade or settlement details provided by counterparties to ensure that they agree with respect to the terms of the transaction.

Maturity date
the date when a financial contract will expire

Member
an equities member, which is a category of authorised user admitted to membership of the JSE under these rules

Money market
the market where short-term securities are traded

N

NCD
Negotiable certificate of deposit
NPS

National Payment System

NPS Department

National Payment System Department

National Payment System

A system operated by the SARB which provides for the total payment process made between banks

National Payment System Department

a department of the SARB which oversees the safety and soundness of the National Payment System

Negotiable certificate of deposit

a fixed deposit receipt issued by a bank that is negotiable in the secondary market as a financial asset.

Netting

a process of summing trades to arrive at a nett settlement position. This means settlement of cash or securities balances by summing all credits and countervailing debits for a given day, then moving cash or securities only in the amount of the nett total.

Non-Bank Participant

an entity who is accepted as a Participant by Strate and who is not licensed under the Banks Act

OTC

Over-the-counter
OTC market

the market which provides for trading of securities which are not listed on a formal exchange

Off-exchange/Off market

trading of securities which is not concluded through an exchange and is reported by the seller and purchaser of the securities to the relevant CSDP for settlement through CSD

Off-exchange trades

bonds to be settled at the CSD which were not traded on an exchange

Off-market settlement

equities to be settled at the CSD which were not traded on an exchange

On-exchange

trading of securities through an exchange

On-exchange trades

bonds to be settled at the CSD which were traded an exchange

On-market settlement

equities to be settled at the CSD which were traded an exchange

On-market transactions

transactions in uncertificated securities which is concluded through the exchange (JSE) for settlement through the CSD

Open-market transactions

SARB transactions in the financial market through which it regulates liquidity
Option

a contract which gives the holder the right, but not the obligation, to buy a specific quantity of an asset at an agreed price at some point or points in the future

P

PFCC

Participant Failure Crises Committee

Participant

a person that holds in custody and administers securities or an interest in securities and that has been accepted in terms of section 34 by a central securities depository as a participant in that central securities depository

Primary market

the place where securities are issued and offered for the first time

Private sector

divisions of the economy not the control of the State

Public sector

divisions of the economy under the control of the State

Promissory note

an unconditional promise in writing made by one person to another, engaging to pay on demand or at a fixed determinable future time, a certain sum of money, to a specified person or his order
R

Rand Overnight Deposit Swap

A swap used to hedge borrowings or investments where the underlying rate of interest is the daily call rate charged or paid by banks

Redemption date

the date on which partial or full return of the debt or securities to the issuer in exchange for a cash value takes place

Regulated person

self-regulatory organisation or any other person who provides or who previously provided securities services

Rematerialisation

the physical withdrawal of previously dematerialised securities held at a CSD

Repurchase agreements

a sale of assets and a simultaneous agreement to repurchase the equivalent assets at a future date or on demand, for the original value plus a return on the use of the cash

Risk management

assessing and controlling risks in order to keep them within acceptable grounds

Rolling settlement

A settlement environment in which uncertificated securities transactions become due for settlement a set number of business days after trade date

S

SAGAAP

South African Statements of Generally Accepted Accounting Practice
SAFEX
South African Futures Exchange

SARB
South African Reserve Bank

SAMOS
South African Multiple Option Settlement

SECA
Stock Exchanges Control Act

SENS
Securities Exchange News Service

SOR
Securities Ownership Register

SRO
Self-Regulatory Organisation

SSA
Securities Services Act

Strate
Share Transactions Totally Electronic Limited

Secondary market
the place where the holders of securities trade once they have been issued

Securities
shares, stocks and depository receipts in public companies and other equivalent equities, other than shares in a share block company as defined in the Share Blocks Control Act 59 of 1980; notes; derivative instruments; bonds; debentures;
anticipatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act 45 of 2002 and units or any other form of participation in a foreign collective investment scheme approved by the registrar of Collective Investment Schemes; units or any other form of participation in a collective investment scheme licensed or registered in a foreign country; instruments based on an index; the securities contemplated that are listed on an external exchange; and an instrument declared by the Registrar by notice in the Gazette to be a security for the purposes of the Companies Act and rights in the securities. The terms securities exclude money market instruments except for the purposes of Chapter IV of the SSA and any security specified by the registrar by notice in the Gazette.

**Securities Account**

an account kept by or on behalf of a participant for a client and reflecting the number or nominal value of securities of each kind deposited and all entries made in respect of such securities.

**Securities Exchange News Service**

A service established by the JSE to provide for the early and wide dissemination of all information that may have an effect on the prices of securities that trade on the JSE.

**Securities Ownership Register**

the central securities account comprising the various money market securities accounts opened and maintained by CSDP’s.

**Securities services**

services provided in terms of this Act in respect of the buying and selling of securities; the custody and administration of securities; the management of securities by an authorised user; the clearing of transactions in listed securities; and the settlement of transactions in listed securities.

**Self-regulatory organisation**

an exchange or a central securities depository.
Sett-off

a method of cancelling or offsetting reciprocal obligations and claims (or the discharge of reciprocal obligations up to the amount of the smaller obligations)

Settlement

completion of a transaction, whereby securities and corresponding cash are delivered and received

Settling party

a buyer or seller of listed securities who settles a transaction or any person appointed in terms of exchange rules by such buyer or seller to settle a transaction on behalf of such buyer or seller

Short-term insurance

insurance that provides protection against specific pure risk and represents the sharing of risk by many to protect the individual policyholder against unexpected perils

South African Futures Exchange

a division of the JSE which deals in derivatives contracts

South African Reserve Bank

the central bank of South Africa

South African Reserve Bank debentures

short-term transferable securities issued by the South African Reserve Bank as a supplementary facility for banking institutions to invest surplus short-term funds

Spot market

the market where one buys or sells currencies for delivery within two to three days
**Swap**

an agreement to exchange cash flows at a predetermined rate or reference rate for a defined period between two parties, often using a net cash settlement of the respective cash flows

**Systemic risk**

the danger of a failure or disruption of the Republic's financial system as a whole

**Total return swap**

allows investors to take a position in an underlying asset without actually owing it. The investor agrees to periodically pay a funding rate in return for receiving the return on an underlying asset. Should default of the reference asset occur, the investor must either compensate the swap counterparty or take delivery of the defaulted asset

**Trade Date**

*a* match to buy and sell securities

**Trading**

*a* match to buy and sell securities

**Trade Reporting**

reporting of trades resulting in change of ownership in securities

**Transnet Limited coupon stocks**

an unsecured short-term security issued by Transnet
Treasury bill

a short-term debt obligation of central government having a maturity of up to one year

U

Uncertificated securities

securities that are not evidenced by a certificate or written instrument and are transferable by entry without a written instrument

Unlisted securities

securities not listed on an exchange and which are traded over-the-counter

UNIDROIT

The International Institute for the Unification of Private Law

W

Warrant

an exchange listed option

World Bank

a international institutions which is a fundamental source of financial and technical assistance to developing countries around the world

Working capital

the amount by which current assets exceed current liabilities
Y

Yield-X

the JSE trading platform for the trading of interest rate products and cash bonds
**ANNEXURE B**
**LIST OF REGISTERED BANKS IN SOUTH AFRICA**

A: Registered Banks - Locally Controlled

1. ABSA Bank Limited
2. African Bank Limited
3. BoE Private Clients
4. Bidvest Bank Limited
5. Capitec Bank Limited
6. Fairbairn Private Bank
7. FirstRand Bank Limited
8. First National Bank
9. Imperial Bank Limited
10. Investec Bank Limited
11. Marriott Merchant Bank Limited
12. MEEG Bank Limited
13. Nedbank Group Limited
14. Nedbank
15. Old Mutual Bank
16. Peoples Bank Limited
17. Go Banking
18. Rand Merchant Bank
19. Regal Treasury Private Bank Limited (In liquidation)
20. Rennies Bank Limited

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http://www2.resbank.co.za/BankSup/BankSup.nsf/$$ViewTemplate+for+Foreign+Banks+Representative+Offices?OpenForm (accessed 11-10-2010).
21. Sasfin Bank Limited  
22. Standard Bank of SA Limited  
23. TEBA Bank Limited  
24. Wesbank

B: Registered Banks – Foreign Controlled

1. Absa Bank Ltd  
2. Albaraka Bank Limited  
3. Habib Overseas Bank Limited  
4. HBZ Bank Limited  
5. Islamic Bank Limited (In Final Liquidation)  
6. Mercantile Bank Limited  
7. The South African Bank of Athens Limited

C: Registered Branches of Foreign Banks

1. ABN AMRO Bank N.V.  
2. Bank of Baroda  
3. Bank of China Johannesburg Branch  
4. Bank of Taiwan Johannesburg Branch  
5. Barclays Bank Plc, South Africa Branch  
6. Calyon Corporate and Investment Bank  
7. China Construction Bank - Johannesburg Branch  
8. Citibank N.A.  
9. Commerzbank Aktiengesellschaft  
10. Deutsche Bank AG  
11. HSBC Bank plc-Johannesburg Branch  
12. JPMorgan Chase Bank, N.A (Johannesburg Branch)  
13. Société Générale  
15. State Bank of India

D: Registered Mutual Banks
1. GBS Mutual Bank
2. VBS Mutual Bank

E: Foreign Banks: Representative Offices

1. AfrAsia Bank Limited
2. Banca Africano de Investimentos
3. Banco BPI, SA
4. Banco Espirito Santo e Comercial de Lisboa
5. Banco Privado Português, S.A.
6. Banco Santander Totta S.A
7. Bank Leumi Le-Israel BM
8. Bank of Cyprys Group
9. Bank of India
10. Barclays Bank Plc
11. Barclays Private Clients International Limited
12. BNP Paribas Johannesburg
13. Commerzbank AG Johannesburg
14. Credit Suisse AG
15. Credit Suisse Securities (Europe Limited)
16. Ecobank
17. Export-Import Bank of India
18. Fairbairn Private Bank (Isle of Man) Limited
19. Fairbairn Private Bank (Jersey) Limited
20. First Bank of Nigeria
21. Fortis Bank (Nederland) N.V.
22. Hellenic Bank Public Company Limited
23. HSBC Bank International Limited
24. Icici Bank Limited
25. KfW Ipex-Bank GmbH
26. Lloyds TSB Offshore Limited
27. Millenium BCP
28. National Bank of Egypt
29. NATIXIS Southern Africa Representative Office
30. Royal Bank of Scotland International Limited

**F: Other Banks**

1. Development Bank of South Africa
2. Land and Agricultural Development Bank of South Africa
3. Postbank
ANNEXURE C
ORGANISATIONAL STRUCTURE OF THE SOUTH AFRICAN RESERVE BANK

Board of directors

Governor

Deputy Governor
Central services

Executive general manager

Departments
Business Systems and Technology
Corporate Services
Legal Services
Human Resources
SARB College
Internal Audit
Executive Management

Deputy Governor
Financial Stability and Research

Executive general manager

Departments
Research
Financial Stability
Currency and Protection Services

Deputy Governor
Markets

Executive general manager

Department
Bank Supervision

Departments
Financial Markets
National Payment System
Exchange Control
Financial Services

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ANNEXURE D
ORGANISATIONAL STRUCTURE OF THE FINANCIAL SERVICES BOARD

ANNEXURE E
REGULATORY AND SUPERVISORY PYRAMIDS OF STRATE

Regulation and Supervision Pyramid (Equities)

*SARB regulates cash only

**For the purpose of settlement assurance

Regulation and Supervision Pyramid (Bonds)

- FSB
  - MOU
  - BESA
  - MOU
  - SROs
  - Strate
    - Controllers and Committees
    - Compliance Officers
    - Management Staff
    - Internal Audit
    - External Auditors
  - The Regulated Entity

- Participants
  - Securities Lending and Borrowing
  - Nominees (local)

- SETTLEMENT
  - CUSTODY
  - CLEARING

- SSA 36 (11 b)

- Issuers
  - Authorised Users

- BESA Listings
  - TRADING
  - CUSTODY

*SARB regulates cash only
Regulation and Supervision Pyramid (Money Market)