TABACKS

Finance Law Update

September 2011

Exchange Control – Validity of transactions

In the case of Oilwell (Pty) Ltd v Protec International Ltd & others [2011] JOL 27137 (SCA), the Supreme Court of Appeal decided that a transaction concluded in contravention of the Exchange Control Regulations, 1961 is not invalid. The facts of the case involved the transfer of rights to a trade mark from a South African company to a UK company without the approval of the Reserve Bank. The transfer was challenged on the basis that it comprised an export of capital in contravention of regulation 10(1)(c) of the Exchange Control Regulations, 1961. Regulation 10(1)(c) provides that no person may export any capital from South Africa without the approval of the South African Reserve Bank. The court decided that: (i) intellectual property rights do not comprise "capital"; and (ii) that a transaction concluded in contravention of the Exchange Control Regulations is not invalid.

Credit Ratings – Proposed Regulation – Credit Rating Services Bill, 2011

The Minister of Finance has published a proposed new law, called the Credit Rating Services Bill, 2011, which provides for the regulation of credit rating agencies.

The Credit Rating Services Bill provides that regulated persons and institutions, such as collective investment schemes, banks and municipalities, must, for regulatory purposes, use only credit ratings issued by credit rating agencies that are registered in accordance with law (s4). The Bill sets out a registration process for credit rating agencies which involves an application to the Financial Services Board (the **"FSB"**), the proposed regulator of credit rating agencies. The Bill sets out various duties of registered credit rating agencies: Credit rating agencies are required to inform the Registrar of the appointment of directors; follow certain minimum standards and requirements in relation to methodologies, models and key rating assumptions when issuing credit ratings; adopt and adhere to a code of conduct; obtain the Registrar's approval before outsourcing; make prescribed disclosures; maintain records; annually publish a report; and establish and maintain an independent compliance function. There are also accounting and auditing requirements for credit rating agencies.

The following draft notices relating to the Bill were also published: rules, fit and proper requirements, form for application for registration, notice relating to the application form, proposed registration fees and form of reports to the FSB.

Financial Markets – Financial Markets Bill, 2011

The government has published a draft law, called the Financial Markets Bill, 2011(the **"Bill"**), to replace the Securities Services Act, 2004 (the **"SSA"**).

The SSA provides for the regulation of securities trading and services. This, broadly speaking, is done by outlawing unlicensed financial markets and related service providers (such as securities clearing and settlement houses) and providing, generally speaking, for securities trading to occur only on a licensed exchange by or through its members (stockbrokers). The Financial Services Board (**"FSB"**) is the designated regulator of securities services under the SSA.

The Bill will, if made law, benefit the JSE Securities Exchange (the only licensed exchange in South Africa) and the JSE settlement system, Strate (the only license clearing house and central securities depository in South Africa) by making it more difficult for potential competitors to obtain licenses and by extending the scope of security services that is reserved only for persons licensed under the Bill.

A new licencing requirement for an exchange (s9(1)), a clearing house (s49(1)) and a central securities depository (s29(1)) is that the applicant must satisfy the FSB that the license will "increase confidence in the South African financial markets"; "promote the protection of regulated persons"; "reduce systemic risk" and "promote the international competitiveness of security services in the Republic". The new requirement may be unconstitutional insofar as it requires an applicant to contribute more, and not simply the same as, the existing licensee.

The Bill provides that all newly issued securities, including the shares and debentures of both private and public companies, must to be lodged and held through a licensed central security depository (s33(1)). Once lodged, the securities may, subject to certain exceptions, be withdrawn from the central securities depository (s35(2)(h), and s41). The FSB may at any time stop further withdrawals from the central securities depository of securities issued by private companies (s36(1)).

The Bill opens the door on requiring centralised clearing of OTC derivatives, a potentially lucrative business reserved for a licensed clearing house (s77(1)(d)).

Section 4(1)(i) of the Bill (read with s78) provides that no person may hold any securities for more than one person without being licensed as a "nominee" by the FSB or a participant of a central securities depository.

Another previously unregulated activity that is provided for in the Bill is the keeping of information regarding securities trades. In terms of section 4(1)(j) no person may maintain a centralised electronic database of transactions in securities unless licensed as a "trade repository". Chapter VI provides for licensing of a trade repository in respect of unlisted securities.

Section 38(3) of the Bill provides that transfers of securities in a central securities depository - which are transferrable by book entry - are effective against third parties. Section 46 provides that such a transfer cannot be challenged by an insolvency administrator. Thus, it seems that a liquidator's

statutory right to set aside certain transactions is excluded in the case of all transfers of securities through the JSE settlement system. An exchange or other regulated person under the Bill may not be placed under liquidation without the approval of the FSB. Certain changes are proposed to the close-out and netting provisions in s35A of the Insolvency Act, 1936. It is doubtful that the changes contribute to clarity.

Chapter X of the Bill sets out insider trading and market manipulation provisions that are, broadly speaking, the same as those currently contained in the SSA.

The Bill provides for various new reporting requirements. Any off-market transaction in listed securities involving a change in beneficial control of 25% or more of the securities must be reported to the FSB which in turn must notify the exchange. The FSB and the exchange may make the information public.

Authorised users are required to hold client money in a separate trust account. If that money becomes mixed with the authorised user's money, the trust money retains its identity as such for so long as it is "identifiable as belonging to" the client (s21(3)).

The Bill affords the JSE, Strate and other license holders the status of self-regulatory organisation (**SROs**) (chapter VII). SRO are to be given wide powers, including the power to impose fines of up to R5million. SRO's, their employees and agents are not accountable for their negligent acts (s73(1).

The Bill seeks to afford the JSE, Strate and any other license holders certain exemptions from the Competition Act, 1998 and the Companies Act, 2008 in regard to amalgamations, mergers, transfers and disposals. The Bill also exempts the JSE and other regulated person from the Consumer Protection Act, 2008.

The motivation for the Bill, as set out in the policy document published together with the Bill, is based to a significant extent on international developments following the recent world-wide financial crisis and the recommendations set out in the Unidroit convention on substantive rules for intermediated securities or the so-called 2008 Unidroit Convention. However, neither South Africa nor any of the other G20 countries have as yet adopted the convention.
