



CHAMBERS
Global Practice Guides

FinTech

Trends & Developments – South Africa

Contributed by
Cliffe Dekker Hofmeyr

2018

SOUTH AFRICA

TRENDS AND DEVELOPMENTS:

p.3

Contributed by Cliffe Dekker Hofmeyr

The 'Trends & Developments' sections give an overview of current trends and developments in local legal markets. Leading lawyers analyse particular trends or provide a broader discussion of key developments in the jurisdiction.

Trends and Developments

Contributed by Cliffe Dekker Hofmeyr

Cliffe Dekker Hofmeyr offers clients a full-service FinTech law solution through its finance and banking practice, regulatory team, technology and sourcing practice, and tax and exchange control practice. Its areas of expertise include advising bank and non-bank FinTech companies on the South African regulatory implications of the products and services they develop. The firm is closely involved in bringing new FinTech products to market. The finance and banking practice, and regulatory team represent the leading FinTech company in South Africa (as rated by the FinTech

Africa Awards 2016) and CDH recently advised Vodacom regarding its M-pesa mobile wallet product. The team also advise on a broad range of issues related to the FinTech sector, including ICT infrastructure, software licensing, distribution, integration and development, telecommunications, services integration and aggregation, helpdesk and desktop support, data protection and privacy, technology turnkey solutions, e-commerce, software and technology-related IP issues and information security.

Authors



Preeta Bhagattjee is a director and national head of the technology and sourcing practice. She has assisted numerous major clients — both within the ICT sector and as customers of ICT services, and in the public and private

sector — on technology and communications law, outsourcing and service-level agreements, e-commerce law, IP and data protection, and privacy issues. A member of the Law Society of the Northern Provinces, Preeta has advised banks on their cloud-based client banking offerings; financial institutions, including most of the large banks in South Africa, on their IT outsourcing services requirements; financial institutions on the outsourcing of various aspects of their voice services requirements; and banks on innovative software development projects and technology turnkey projects.



Deon Wilken a director and practice head, leads the national banking and finance team based in the Johannesburg office. Deon's other areas of expertise are financial markets, securities law, banking law and credit law. Most recently, Deon, a

member of Law Society of the Northern Provinces, has advised app developers and banks regarding the South African payment and settlement systems, the Payments Systems Act, credit card payment clearing house agreements, merchant acquiring and cross currency settlements; advised Vodacom regarding its M-pesa mobile wallet product; advised Absa Bank on an e-money product and banking law regulation of mobile money; and provided opinions on financial and payment regulation to Lufthansa, Fedex, Accenture, HSBC, Nedbank, Elavon and numerous merchant acquirers and system operators.



Bridget King a partner, focuses on banking regulation, financial markets regulation and derivatives. She is local South African counsel to ISDA Inc; provides ISDA with industry opinions on the collateral, clearing and margin

arrangements for OTC derivatives under ISDA agreements; and assists with ISDA's initiatives in Africa. Bridget continues to advise EasyEquities on the development of a ground-breaking online trading platform that creates an important market precedent in South Africa for the trade of fractional share rights. She advises FinTech companies in respect of their mobile device apps, online trading platforms, fractional share rights trading, derivatives, contracts for difference, mobile money and non-bank lending. Bridget is a member of the Law Society of the Northern Provinces and is a Registered Person (Equities) with the South African Institute of Financial Markets.



Sascha Graham is an associate in the finance and banking practice, whose main focus is on financial services' legislation which includes the regulation of local and foreign services providers, market infrastructures, local and foreign collective

investment schemes and local and foreign banks in South Africa. Sascha has also advised on limitations in respect of the implementation of mobile money in South Africa, contracts for difference and derivatives. Sascha is a member of the Law Society of Northern Provinces and is a member of the Golden Key Honours Society.

SOUTH AFRICA TRENDS AND DEVELOPMENTS

Contributed by Cliffe Dekker Hofmeyr **Authors:** Preeta Bhagattjee, Deon Wilken, Bridget King, Sascha Graham

Introduction

The current South African regulatory environment has allowed for the development of novel FinTech products and services in the investment and securities trading industry. In particular, FinTech companies like EasyEquities and SatrixNow are disrupting the traditional retail investment market by providing innovative investment platforms for South African consumers and institutional investors.

Fractional Share Rights

One notable innovation is the introduction of South Africa's (and indeed Africa's) first online securities trading platform, which offers the purchase and sale of whole securities and fractional securities rights (FSRs) that reference a portion of an underlying whole security listed on the Johannesburg Stock Exchange (JSE). EasyEquities developed the FSR in response to the economic barriers preventing the majority of retail investors from participating in the South African financial markets. Prevailing socio-economic factors in South Africa have meant that a large section of the South African population have been unable to invest in JSE-listed shares and other securities because of the prohibitive cost structures and minimum investment amounts.

Legal and Regulatory Backdrop

- Under South African law, it is not possible for an investor to own (as true and beneficial owner) a fraction of a listed security. In addition, the Rules and Directives of the JSE and the central securities depository, Strate, do not accommodate the trading and administration of fractions of listed securities.
- South African law does, however, permit the trade of OTC contracts for difference (CFDs). CFDs fall within the definition of a "derivative instrument" under the Financial Markets Act, 2012 (the "Financial Markets Act") and are therefore regulated as "financial products" under the Financial Advisory and Intermediary Services Act, 2002 (FAIS). FAIS requires that any person who provides advice or intermediary services (including active or conscious sales and marketing activities) in respect of a financial product (including a derivative instrument) may only do so as a licensed financial services provider and then only in accordance with the provisions of FAIS. Save for these regulations, the trade of OTC derivatives like CFDs on a principal-to-principal basis is largely unregulated. Whilst any advice or marketing of CFDs is regulated, the contractual arrangement between the CFD provider and the investor is not.
- For many years, a number of South African banks and financial services providers have been offering online CFD trading platforms to South African investors issuing CFDs over various listed instruments, commodities and currencies. These CFD providers include The Standard Bank of South Africa, Nedbank, IG Markets, PSG, First World

Trader Proprietary trading as GT247.com, ACM Gold and London Capital Group trading as Sanlam iTrade, etc.

- Traditional stockbroking firms (authorised members of the JSE) facilitate the trade in whole JSE-listed securities, subject to the rules and directives of each of the JSE's divisions, the Rules of Strate and the Financial Markets Act.

Fractional Share Rights Development

- EasyEquities (a trading division of First World Trader) developed a new platform and product called EasyEquities (within South Africa's unique regulatory environment) to address a legal and socio-economic barrier excluding certain segments of South Africa's population from investing in JSE-listed securities. Typically, the less money an investor has to invest, the more likely that investor is to invest in the "penny stocks" listed on the exchange. Stocks that trade at the lowest prices are often the most risky of the investments, offering the lowest returns. It is also difficult for an investor to build an appropriately diversified portfolio of shares when an investor has limited financial resources. This created the situation where certain investors were precluded from investing in South Africa's high-performing "blue chip" companies as the shares were simply too expensive to buy in the required quantities at the minimum investment amounts, given the exchange costs. In addition, proper diversification was not possible with limited financial resources, leaving the investor with exposure to a single name.
- EasyEquities developed a product essentially addressing the problems experienced by retail investors by allowing investors to buy whole shares and, in instances where the investor does not have sufficient funds to buy a whole share, fractional share rights over that whole share. In short, the platform developed a hybrid financial product that combines 100% margined CFDs with whole shares.
- First World Trader (the legal entity operating the EasyEquities platform) acts as an agent for the issue of whole shares (in other words, as a traditional stockbroker with the relevant licences), where the investor becomes the registered owner of all the whole shares it can afford to buy, entitled to dividends, participation in corporate actions and all the economic benefits and risks associated with share ownership. In respect of FSRs, First World Trader acts as principal to a 100% margined CFD issued to the investor, where the investor has a contractual claim against First World Trader to the economic benefits and risks associated with share ownership (profits and losses due to price movements and dividends) without having ownership rights in the underlying share. As the investor makes further investments in FSRs and ultimately ends up with a whole share, the CFD is closed out and ownership of the whole share is delivered to the investor.

Legal Treatment of Fractional Share Rights

- Where an investor places a rand-denominated investment on the EasyEquities platform and that rand amount is not sufficient to buy one or more whole shares, the platform will give effect to the order by entering into a CFD transaction with the investor in terms of which the underlying reference instrument will be a percentage of the whole share specified in the investor's order. The platform will act as principal to the CFD transaction with the investor. The underlying reference instrument of the CFD transaction will be calculated pro rata according to the corresponding percentage of the investment amount relative to the share price that would have been paid in respect of a whole share.
- For example, where a whole share costs ZAR500 per share and the investor seeks to invest only ZAR200 in the share, the investor will qualify for a CFD that represents 40% of the value of the whole share. This gives the investor exposure to the economic benefits of a 40% interest in a whole share. As with all CFD contracts, the investor does not own the underlying reference instrument and will merely have a contractual claim against the platform under the CFD transaction. The investor is exposed to the economic benefits (profit or loss due to price movements in respect of the securities) but does not become the true, beneficial owner of the underlying reference instrument. In a scenario where the investor made an investment of ZAR200 in a particular share, that investor may purchase further fractional share rights on future dates; for example, by placing orders for another ZAR200-worth of that share.
- Once the investor has purchased sufficient fractional share rights that add up to 100% of the value of a whole share, the platform closes out the CFD transactions and issues the investor with a whole share. The investor becomes the true beneficial owner of that whole security. This means that even where a share carries a high value, the investor is able to enter the market even with a relatively low investment amount with a view to building up to owning one or more whole shares in the future. The platform also permits investors to set up recurring investments and debit orders so that the investor can increase their investments over time.
- Fractional share rights do not carry voting rights and investors do not participate in corporate actions in respect of fractional securities rights. Voting rights and participation in corporate actions apply only to whole securities owned by an investor.
- If a particular investor only has ZAR2,000 to invest in the stock market, they could place a ZAR100 investment in 20 different shares (issued by means of fractional share rights and whole shares), allowing them to diversify their portfolio.
- Although whole shares and fractional share rights are discussed here, the EasyEquities platform offers investments in all JSE-listed securities, not just shares.
- The platform has developed a further innovative concept, allowing investors to purchase baskets of multiple shares

- (“Baskets”) by placing a single order. Certain service providers contracted to the platform have developed their own share Baskets, which are published on the platform. The Baskets merely represent the Basket creator's preferred list of stocks. Investors can then place orders that replicate the original Baskets of shares and mirror the exact composition of the Basket. These Baskets are static and not a managed solution. If investors would like to invest in managed share bundles of whole securities and FSRs (“Bundles”), they may do so by signing additional Bundle investment management mandates in terms of which investment managers will create weighted Bundles of shares and actively manage the composition and weighting of certain Bundles published on the website. An investor's Bundle is updated as the primary Bundle is updated, re-weighted or amended.
- The EasyEquities platform now allows South African investors to make use of their ZAR33,000 tax-free savings allowance (made available by new dispensations under the Income Tax Act, 1962) by allowing investors to purchase whole and fractional securities rights in qualifying exchange-traded funds listed on the JSE. The EasyEquities platform will soon offer the products of third-party financial services providers so that investors will be able to manage multiple investments with multiple financial services providers, all through a single platform.
 - There is also scope for the platform to offer securities listed on US securities exchanges, a development which will soon be launched in the market.
 - More recently, one of the largest financial services providers in South Africa, Sanlam, elected to white-label the EasyEquities platform in order to provide a similar product (SatrixNow) to its client base. Satrix is one of the largest providers of JSE-listed tracker funds and now offers the hybrid FSR product on its SatrixNow platform.
 - The platform technology and the cost-cutting efforts of the platform provider ensure that investors pay only 64 cents per ZAR100 invested. This again permits local South African investors to participate in the purchase of JSE-listed shares.

Market Response to Fractional Share Rights

Journalists have heralded the fractional share rights offered on the EasyEquities platform as the first product truly to “democratise share ownership in South Africa.” The product has won numerous awards, including the No 1 African FinTech Company at the 2016 FinTech Africa Awards, No 1 African Investment Technology Company at the FinTech Africa Awards, No 1 Online Stockbroker and No 1 Tax-Free Savings Account by the Financial Mail Investor's Monthly Intellidex as well as the overall No 1 Most Innovative Concept at the Accenture Innovation Index Awards for 2015 and 2016.

Response by Regulators

- Significant time and energy was invested educating the regulators and bringing the EasyEquities platform and

SOUTH AFRICA TRENDS AND DEVELOPMENTS

Contributed by *Cliffe Dekker Hofmeyr* **Authors:** Preeta Bhagattjee, Deon Wilken, Bridget King, Sascha Graham

product to market in South Africa. Whilst the Financial Services Board does not regulate CFDs or fractional share rights, it nevertheless imposed certain additional requirements on EasyEquities with respect to requirements for the customer-facing terms and conditions, investor disclosures and legal agreements. Initially, the JSE and Strate were concerned about the offering of fractional share rights products but the product proved permissible and could operate fully within the South African regulatory framework.

- It is anticipated that whilst EasyEquities and SatrixNow represent the first of their kind in the development of these particular investor FinTech products, similar providers and financial services disrupters will follow suit by re-evaluating their existing online savings, investment and trading platforms.

Cliffe Dekker Hofmeyr

Johannesburg Regional Office
1 Protea Place
Sandown
Gauteng
South Africa
2196



Tel: +27 11 562 1027
Fax: +27 11 562 1111
Email: Bridget.King@cdhlegal.com
Web: <http://www.cliffedekkerhofmeyr.com/>