FINANCIAL MARKETS

A market in which people and entities can trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand. Securities include stocks and bonds, and commodities include precious metals or agricultural goods.
INTRODUCTION

The South African authorities have adopted the approach, as encountered in numerous jurisdictions around the world, that self-regulation by market participants is more desirable and acceptable than regulation imposed and monitored by the state.

However, exchanges need to be licensed in terms of the Financial Markets Act, 2012 (Financial Markets Act). The Financial Markets Act provides for the regulation of financial markets and, among other things, regulates securities services, including the provision of over-the-counter (OTC) derivatives. The Financial Markets Act focuses on the regulation of exchanges, central depositories, clearing houses and their members. The Financial Sector Conduct Authority is responsible for the regulatory and supervisory functions under the Financial Markets Act. The Financial Sector Conduct Authority is the authority established in terms of the Financial Sector Regulation Act, 2017.

The Financial Markets Act was introduced to ensure that South Africa’s financial markets, and the regulation thereof, are brought in line with global standards. The Financial Markets Act also tightens up certain provisions relating to insider trading and other market abuse. The Regulations to the Financial Markets Act published under Government Notice R98 in Government Gazette 41433 (Regulations) primarily govern the provision of OTC derivatives. Among other things, the Regulations create the concept of an “OTC derivatives provider” and require all OTC derivatives providers to be licensed.
In addition to being regulated by the Financial Markets Act, the JSE is also subject to its own set of self-regulatory rules, the JSE Rules and, among other requirements, the JSE Equity Listings Requirements applicable to the Main Board of the JSE (JSE Equity Listings Requirements) and the JSE Debt Listings Requirements applicable to the Interest Rate Market of the JSE (JSE Debt Listings Requirements).

The JSE provides a forum and infrastructure for the listing and trading of the securities (including equity securities and debt securities) of domestic and foreign companies.

THE MAIN BOARD OF THE JSE

In the context of corporate actions and certain corporate governance aspects, the JSE Equity Listings Requirements go beyond the requirements of the Companies Act, 2008 (Companies Act) and impose more stringent obligations and requirements on listed companies.

The black economic empowerment (BEE) segment is a segment of the Main Board of the JSE on which an issuer may list its BEE securities and where trading in such securities is restricted to BEE compliant persons.

In order for an entity to qualify for Main Board listing it must meet the prescribed requirements.

The JSE also offers an alternative exchange known as ‘AltX’. AltX is a market for small to medium companies that are in a growth phase.

A JSE Main Board listing may be achieved through a ‘front door listing’ consisting of a public issue of shares or a private placing. A ‘front door listing’ is achieved without the use of a company that is already listed. A combination of a private placing and public issue is also possible.

A ‘back door listing’ is achieved through the reverse take-over of a listed company (usually a cash shell) by an unlisted company, thereby achieving the de facto listing of the purchaser. The potential advantage of a listing is often obtained in this way without requiring the shareholders of the company to dispose of a large portion of their interests.

The JSE also has a ‘fast-track’ listing mechanism which provides for an entity with a primary listing on any ‘accredited exchange’ (Australia, London, New York or Toronto) to apply for secondary listing on the Main Board of the JSE in a quicker and simplified manner.

JSE DERIVATIVES MARKETS

The South African Futures Exchange (Safex) of the JSE provides for derivatives markets, consisting of a commodity derivatives market, equity derivatives market, currency derivatives market, bond derivatives market and interest rate derivatives market. The JSE derivatives markets are the principal markets in South Africa for the trade in derivative financial products. The JSE derivatives markets have kept abreast of developments in world financial markets and offer the possibility of trade in a number of different derivative products to the institutional and retail
THE INTEREST RATE MARKET OF THE JSE

The Interest Rate Market of the JSE is a separate platform or sub-market of the JSE on which “debt securities”. The JSE Debt Listings Requirements, promulgated under the Financial Markets Act regulate the Interest Rate Market of the JSE.

Debt securities include, without limitation, debentures, debenture stock, loan stock, bonds, notes, certificates of deposit, preference shares or any other instrument creating or acknowledging indebtedness.

The registration of a Placing Document and the listing of debt securities on the Interest Rate Market of the JSE are regulated by the JSE Debt Listings Requirements.

The JSE Debt Listings Requirements contain the rules and procedures governing new applications, the prescribed contents of the Placing Document and, where applicable, the Pricing Supplement, and the continuing obligations which are applicable to the issuers of debt securities.

Where debt securities are issued to the “general public” as defined in the Banks Act, 1990 (Banks Act), the Placing Document and, where applicable, the Pricing Supplement of a non-bank issuer of such debt securities must comply with an available exemption to ‘the business of a bank’ under the Banks Act. The exemptions which are generally applicable are colloquially known as the Commercial Paper Regulations and the Securitisation Regulations.

The Placing Document of a bank issuer of debt securities, the proceeds of which are to qualify as ‘additional tier 1 capital’ and ‘tier 2 capital’, must comply with the Banks Act and Regulations 38(11) and (12) or the Regulations Relating to Banks published in Government Gazette No. 40002 of 20 May 2016 (Regulations Relating to Banks). The Banks Act and the Regulations Relating to Banks provide for the implementation of the Basel III Accord in South Africa.
4 AFRICA EXCHANGE PROPRIETARY LIMITED

4 Africa Exchange Proprietary Limited (4AX) is also licensed to operate as an exchange in terms of the Financial Markets Act. 4AX provides a forum and infrastructure for the listing and trading of equity and debt securities. In addition to being regulated by the Financial Markets Act, 4AX is also subject to its own set of self-regulatory rules and, among other requirements, the 4AX Equity Listings Requirements applicable and the 4AX Debt Listings Requirements.
Strate Proprietary Limited (CSD) is licensed as a central securities depository in terms of the Financial Markets Act. The CSD is the operator of an electronic clearing system which matches, clears and facilitates the settlement of all transactions carried out in respect of securities which are held in the CSD.

Securities which are issued uncertificated form in terms of Chapter IV of the Financial Markets Act (Securities) must be held in the CSD.

Securities which are held in the CSD are issued, cleared and transferred in accordance with the CSD Procedures through the electronic settlement system of the CSD. The settlement of trades in Securities take place in accordance with the electronic settlement procedures of the CSD.

Securities will be settled through participants in the CSD (CSD Participants) who comply with the electronic settlement procedures prescribed by the CSD.

The CSD maintains central securities accounts only for CSD Participants. CSD Participants are responsible for the settlement of scrip and payment transfers through the CSD and the South African Reserve Bank.

The clients of CSD Participants may include the registered holders of Securities or their custodians. The CSD Participants will maintain records of Securities held by their clients.

Subject to the CSD Procedures, the registered holders of Securities may exercise their rights in respect of such Securities through their CSD Participants.

Title to Securities is reflected in the central securities accounts maintained by the CSD and the relevant CSD Participants for the registered holders of such Securities.

Title to Securities passes on transfer thereof by electronic book entry in the central securities accounts maintained by the CSD and the relevant CSD Participants for the holders of such Securities. Securities may be transferred only in accordance with the CSD Procedures.

Subject to the Financial Markets Act, Securities may be exchanged for Securities in registered certificated form.
South Africa’s takeover laws are contained in the Companies Act and the Takeover Regulations promulgated under the Companies Act (Takeover Regulations). The Takeover Regulations are based to some extent on the City Code on Takeovers and Mergers issued by the London Panel on Takeovers and Mergers.

The main object of the Takeover Regulations is to ensure fair and equal treatment of all holders of securities in relation to affected transactions. The Takeover Regulations also provide an orderly framework within which affected transactions must be conducted.

The TRP is not concerned with the commercial advantages and/or disadvantages of a transaction, nor is the TRP concerned with competition policy, although it does take note of any rulings by the competition authorities.

The Takeover Regulations apply where an offeree company is a regulated company as contemplated in the Companies Act. Regulated companies include public companies, whether or not listed on any stock exchange, and state-owned companies. They also include private companies if over 10% of the voting securities of that company were transferred among unrelated persons in the 24 months preceding the affected transaction.

The TRP may exempt any particular transaction if it is satisfied that there can be no prejudice to minority shareholders, it is just and equitable to do so or the costs of compliance with the Takeover Regulations is disproportionate relative to the value of the transaction.

A person may not give effect to an affected transaction unless the TRP has issued a compliance certificate with respect to the transaction or granted an exemption for that transaction.

The Companies Act and Takeover Regulations also regulate ‘partial offers’ extensively. These are offers made to shareholders of a regulated company for a certain percentage of their shares.
EXCHANGE CONTROL REGULATIONS

In principle, no person may transfer any assets (including cash and securities) out of South Africa or make any payment to a non-resident or give any security in favour of a non-resident without the prior written approval of the Financial Surveillance Department of the South African Reserve Bank (Exchange Control Authorities) in terms of the Exchange Control Regulations, 1961 promulgated pursuant to the Currency and Exchanges Act, 1933 (Exchange Control Regulations). These restrictions include, among other things, the issue of foreign-issued securities by a foreign issuer on the primary market and the purchase of foreign-issued securities by South African resident investors on the secondary market.

For the purposes of the Exchange Control Regulations, a South African resident is any person (including a legal entity) who or which has taken up permanent residence, is domiciled or is registered in South Africa. A non-resident is any person (including a legal entity) who or which is not a South African resident. If a non-resident maintains a branch in South Africa, then such branch will be deemed to be a separate legal entity and will be considered to be South African resident for the purposes of the Exchange Control Regulations.

Applications for approval under the Exchange Control Regulations are effected through “authorised dealers” in foreign currency (Authorised Dealers) who assist the Exchange Control Authorities with the monitoring and enforcement of the Exchange Control Regulations. Authorised Dealers include the major South African banks, and the local branches of foreign banks, which are approved by the South African Reserve Bank as “authorised dealers” in foreign currency.

An approval under the Exchange Control Regulations may take the form of (i) a “specific” approval granted pursuant to a specific individually motivated application to the Exchange Control Authorities for exchange control approval or (ii) a “general pre-approval” which may take the form of an Exchange Control Circular, Directive or Ruling and which, subject to the applicable conditions specified in the relevant Exchange Control Circular, Directive or Ruling, applies generically to certain classes of transactions or all transactions of a particular kind.

The application of the Exchange Control Regulations is set out in the Exchange Control Rulings and the Currency and Exchanges Manual for Authorised Dealers (Manual), as read with the Exchange Control Circulars and the Exchange Control Directives, each published by the Exchange Control Authorities.
The approval contemplated in a “general pre-approval” can be granted by Authorised Dealers, subject to compliance by the applicant with the applicable conditions specified in the relevant Exchange Control Circular, Directive or Section of the Manual. Examples of “general pre-approvals” include, among others, the following:

- The “general pre-approval” set out in Section B.2 (Capital Transfers) – Section A (General) and Section (B) (Private individuals resident in South Africa) – (i) (Foreign investments by private individuals (natural persons) resident in South Africa) of the Manual (Private Foreign Investment Approval) allows certain natural persons to transfer (as a foreign capital allowance) up to ZAR10,000,000 per year for investment purposes abroad, subject to the conditions set out in the Private Foreign Investment Approval.

- The “general pre-approval” set out in Section B.4 (Single discretionary allowance and other miscellaneous payments for private individuals) – Section A (Single discretionary allowance per calendar year) (Discretionary Allowance Approval) of the Manual allows residents (natural persons) who are 18 years and older to avail themselves of “a single discretionary allowance within an overall limit of R1 million per individual per calendar year without the requirement to obtain a Tax Clearance Certificate”. The amount transferred off-shore pursuant to the Discretionary Allowance Approval “may be used for any legal purpose abroad”.

- The “general pre-approval” set out in Section B.2 (Capital Transfers) – Section A (General) and Section (H) (South African institutional investors) (Foreign Portfolio Investment Approval) of the Manual allows foreign-issued securities to be subscribed for or purchased by institutional investors (comprising all retirement funds, long-term insurers and collective investment scheme management companies) using their “foreign portfolio investment allowances”. Investment managers which register as institutional investors with the Exchange Control Authorities may also subscribe for or purchase foreign-issued securities using their “foreign portfolio investment allowances”.

The onus for obtaining all exchange control approvals (or for ensuring that the relevant transaction is covered by a “general pre-approval”) lies with the relevant South African resident.

The Exchange Control Directive entitled “Inward Listings by Foreign Entities on South African Exchanges” (Inward Listings Directive) enables non-South African issuers, subject to the provisions of the Inward Listings Directive, to issue certain specified types of securities to investors in South Africa provided, among other things, such securities are “inwardly listed” on the JSE All issues of “inwardly listed” debt securities require the prior written approval of the Exchange Control Authorities.
NEW AND PENDING FINANCIAL MARKETS LEGISLATION

FINANCIAL SECTOR REGULATION ACT

As part of South Africa’s ‘Twin Peaks’ legislation which aims to regulate the entire financial sector (Twin Peaks legislation and Twin Peaks) the Financial Sector Regulation Act, 2017 (Financial Sector Regulation Act) was enacted on 21 August 2017. Certain sections of the Financial Sector Regulation Act came into effect in March 2018. A Commencement Notice sets out the various commencement dates for various other sections of the Financial Sector Regulation Act and provides for the adoption of a “phased-in” approach.

The Financial Sector Regulation Act is a vast, omnibus of an Act whose aim is, among other things, to “establish a system of financial regulation by establishing the Prudential Authority and the Financial Sector Conduct Authority”, to “preserve and enhance financial stability in [South Africa] by conferring powers on the [South African] Reserve Bank”, to establish the Financial Stability Oversight Committee and to “regulate and supervise financial product providers and financial services providers”.

The Financial Sector Regulation Act applies to all “financial institutions”, including banks. In addition, the Financial Sector Regulation Act has amended certain sections of specific legislation dealing with the South African financial services industry, such as (among others) the Banks Act and insurance legislation.

The enactment of the Financial Sector Regulation Act, amongst other things, creates two new regulators tasked with regulating the financial services sector. In terms of the Financial Sector Regulation Act:

- the Prudential Authority is responsible for the safety and soundness of financial institutions so that these institutions are able to make good on financial commitments to customers.
- the Financial Sector Conduct Authority (FSCA), is responsible for the conduct of financial institutions and the fair treatment of financial customers, financial education and the efficiency and integrity of the financial markets.
- both the Prudential Authority and the FSCA have jurisdiction over all financial institutions in South Africa.
The Financial Sector Regulation Act is an overlay on existing financial sector laws. These laws remain in place, allowing the regulators to regulate and supervise the sector both in terms of the Financial Sector Regulation Act and existing laws. The Financial Sector Regulation Act provides for greater consistency in regulatory operations and is a first step in the move toward full comprehensive legislative reform.

The Financial Sector Regulation Act primarily deals with the regulatory architecture of the Twin Peaks model. The Financial Sector Regulation Act establishes the regulatory authorities and sets requirements for how they must operate. It also sets out the supervisory and enforcement powers of the regulators and establishes the Financial Services Tribunal as an independent body providing an accountability check for regulators (and other defined decisionmakers).


The next phase of the reform process from a market conduct perspective will be to streamline and harmonise the legal landscape that financial institutions will operate within. This entails a comprehensive review of existing financial sector laws, with the aim of developing a single, holistic legal framework for market conduct regulation in South Africa that is consistently applied to all financial institutions. The Conduct of Financial Institutions Bill [B — 2018] (COFI Bill) provides for this new legal framework. The COFI Bill also proposes amendments to (among other statutes) the Financial Sector Regulation Act.

The COFI Bill is aimed at strengthening the regulation of the financial sector in relation to customer treatment and general market conduct. The FSCA is the relevant regulator under the COFI Bill.
NEW AND PENDING FINANCIAL MARKETS LEGISLATION/ continued

Whereas the Financial Sector Regulation Act gives customers and financial institutions an indication of what to expect of financial sector regulators, the COFI Bill outlines what customers and industry players can expect of financial institutions. It aims to streamline the legal framework for regulating the conduct of financial institutions, and to give legislative effect to the market conduct policy approach, including the implementation of the Treating Customers Fairly (TCF) principles.

The Financial Sector Regulation Act is ‘regulator-facing’: it also provides the regulators with certain powers in relation to regulated entities, to ensure that current gaps in the legislative framework do not prevent the regulators from meeting their respective mandates (for example, allowing the FSCA to set standards on banks).

In contra-distinction, the COFI Bill will be primarily ‘regulated entity-facing’ – setting the requirements that financial institutions under the jurisdiction of the FSCA must meet and the outcomes they are expected to deliver. While the Financial Sector Regulation Act gives consumers and financial institutions an indication of what to expect of the regulators in the financial sector, the COFI Bill will give customers and industry players an indication of what is expected of financial institutions.

RECOVERY AND RESOLUTION LEGISLATION

The South African Reserve Bank (SARB) and the National Treasury are in the process of implementing a statutory bail-in option under South African law (Recovery and Resolution Legislation). The Recovery and Resolution Legislation (which is not yet law) is expected to implement a statutory bail-in option under South African law, and is expected to be based on the principles set out in, among others, the document entitled “Strengthening South Africa’s Resolution Framework for Financial Institutions” (Resolution Framework) and the document entitled “Ending too big to fail: South Africa’s intended approach to bank resolution” (SARB Document), as well as the provisions of the Financial Sector Laws Amendment Bill [B — 2018] (FSLAB).

The bail-in option will empower the SARB (as the resolution authority) to re-capitalise a failed financial institution by allocating losses to its shareholders and unsecured creditors in a manner that respects the hierarchy of claims in an insolvency of the relevant financial institution, consistent with shareholders and creditors of the relevant financial institution not
receiving less favourable treatment than they would have done in insolvency. The bail-in option will include the power to cancel a liability or modify the terms of contracts for the purposes of reducing or deferring the liabilities of the financial institution (including both senior and subordinated liabilities) and the power to convert a liability from one form to another.

**THE RESOLUTION FRAMEWORK**

The Resolution Framework, which was released in August 2015, sets out the motivation, principles and policy proposals for a strengthened framework for the resolution of designated financial institutions in South Africa.

**THE SARB DOCUMENT**

The SARB Document, which was released in 2019, outlines the key components required to formulate credible resolution plans, including the ability to recapitalise a bank at short notice, while ensuring access to funding and liquidity, maintaining critical functions and services and mitigating against financial market instability. The SARB Document outlines the statutory powers of the SARB (as the resolution authority) in terms of bail-in, including the issuance of so-called ‘FLAC instruments’. These ‘FLAC instruments’, while not qualifying as regulatory capital, comprise debt instruments which could be ‘baled-in’ during resolution.

**THE FSLAB**

The FSLAB is intended to provide for the resolution process contemplated in the SARB Document, and to give effect to certain proposals contained in the Resolution Framework and the deposit insurance discussion policy document entitled “Designing a Deposit Insurance Scheme for South Africa” which was released on 30 May 2017.

The FSLAB seeks to strengthen the ability of the SARB (as the resolution authority) to manage the orderly resolution or winding down of a failing financial institution, with minimum disruption to the broader economy. In addition, the FSLAB seeks to ensure that depositors’ funds are protected in the event of a bank failure, and that depositors’ funds will be paid out speedily to protect the most vulnerable customers. The FSLAB, when enacted, will apply to all registered South African banks, including mutual and cooperative banks.

The FSLAB also provides for the ‘No Creditor Worse Off’ rule: The SARB must not take resolution action in relation to a designated institution in resolution that would result in a creditor or shareholder of the designated institution receiving less than the creditor or shareholder would have received if the designated institution had been wound up.
The FSLAB provides for the issuance of so-called ‘FLAC instruments’. The FSLAB defines a ‘FLAC instrument’ (also described as a ‘flac instrument’) as “a financial instrument to which [among others, a bank] is a party, being an instrument that —(a) complies with the requirements prescribed by a prudential standard for a flac instrument; and (b) is of a kind that is not counted for the purpose of determining whether [among others, the bank] satisfies the applicable requirements of [among others] Chapter VI ([PRUDENTIAL REQUIREMENTS]) of the Banks Act …; or prudential standards made for the purposes of any of those provisions”.

In order to give effect to the resolution process contemplated in the SARB Document, the FSLAB proposes far-reaching amendments to (among other statutes) the Banks Act, the Financial Sector Regulation Act, the Insolvency Act, 1936, the Companies Act and the Financial Markets Act.
EQUITY CAPITAL MARKETS AND GENERAL COMMERCIAL LAW

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