



# SOUTH AFRICA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### DETAILED ASSESSMENT OF IMPLEMENTATION ON THE IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

This Detailed Assessment of Implementation on the IOSCO Objectives and Principles of Securities Regulation on South Africa was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in February 2015.

March 2015

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# SOUTH AFRICA

## DETAILED ASSESSMENT OF IMPLEMENTATION

February 2015

## IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

Prepared By  
**Monetary and Capital  
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in South Africa during May 2014, led by Cheng Hoon Lim, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at

<http://www.imf.org/external/np/fsap/fsa.aspx>.

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## Glossary

AFU	Asset Forfeiture Unit of the NPA
AFS	Annual Financial Statements
APA	Auditing Profession Act, 2005 26 of 2005
ASISA	Association for Savings and Investment South Africa
AUM	Assets under Management
Bankserv	Bankers Services Co Limited
BASA	Banking Association of South Africa
BCP	Basel Core Principles
BDA system	Broker-Dealer Accounting system at JSE
BN 127	Notice on Qualifications, Experience and Criteria for Approval of Compliance Officers, Board Notice 127 of 2010
Board Notice 80	Determination of Securities, Classes of Securities, Assets or Classes of Assets that May be Included in a Portfolio of a Collective Investment Scheme in Securities and the Manner in which and Limits and Conditions Subject to which Securities and Assets May Be Included, Board Notice 80 of 2012
Board Notice 571	Hedge Fund FSP Risk Disclosures, Board Notice 571 of 2008
CCP	Central Counterparty
CFAS	Committee for Auditing Standards
CIPC	Company and Intellectual Property Commission
CIS	Collective Investment Scheme
CISCA	Collective Investment Schemes Control Act 45 of 2002
Codes of Conduct for Administrative and Discretionary	Codes of Conduct for Administrative and Discretionary Financial Services Providers, Board Notice 79 of 2003
FSPs	
CRA	Credit Rating Agency
CRSA	Credit Rating Services Act 24 of 2012
CSD	Central Securities Depository
CSP	Custody Service Provider
DA	Designated Adviser
DAC	Disciplinary Advisory Committee of IRBA
DMA	Directorate of Market Abuse
DTI	Department of Trade and Industry
EC	Enforcement Committee of the FSB
ETF	Exchange Traded Fund
FAIS Act	Financial Advisory and Intermediary Services Act 37 of 2002
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act 38 of 2001
Fit and Proper Notice	Determination of Fit and Proper Requirements for Financial Services Providers, Board Notice 106 of 2008
FMA	Financial Markets Act 19 of 2012

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FMI	Financial Market Infrastructure
FRIP	Financial Reporting Investigation Panel
FRP	Financial Reporting Pronouncements
FRSC	Financial Reporting Standards Council
FSB	Financial Services Board
FSB Act	Financial Services Board Act 97 of 1990
FSCF	Financial Sector Contingency Forum
FSOC	Financial Stability Oversight Committee
FSP	Financial Services Provider
GAAP	Generally Accepted Accounting Principles
General Amendment Act	Financial Services Laws General Amendment Act, 2013 45 of 2013
General Code of Conduct	General Code of Conduct for Authorized Financial Services Providers and Representatives: Custody of Financial Products and Funds, Board Notice 80 of 2003
IAASB	International Auditing and Assurance Standards Board
IAASB Handbooks	IAASB Handbooks of International Quality Control, Auditing, Assurance, and Ethics Pronouncements
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
INFE	International Network on Financial Education
Inspection Act	Inspection of Financial Institutions Act 80 of 1998
IOSCO	International Organization of Securities Commissions
IRBA	Independent Regulatory Board for Auditors
IRBA Code	IRBA Code of Professional Conduct and Disciplinary Rules
IRC	Interest Rate and Currency (market of the JSE)
ISA	International Standards on Auditing
ISQC	International Standard on Quality Control
ISP	Investment Service Provider (at JSE)
JSE or exchange	Johannesburg Stock Exchange
King III Code	King Report on Governance for South Africa 2009
LISP	Linked Investment Service Provider
MHI	Medium-High Impact
MMF	Money Market Fund
MMOU	Multilateral Memorandum of Understanding
MOU	Memorandum of Understanding
NAV	Net Asset Value
Notice 573 of 2003	Suspension of Repurchase of Participatory Interests by Manager of Collective Investment Scheme in Securities, Board Notice 573 of 2003
Notice 910	Determination of Fit and Proper Requirements and Conditions for Managers of Collective Investment Schemes, Board Notice 910 of 2010
NPA	National Prosecuting Authority

OEA	Order Entry Application (at JSE)
OTC	Over-the-counter
PAAB	Public Accountants and Auditors Board Act (repealed)
PAJA	Promotion of Administrative Justice Act 3 of 2000
PASA	Payments Association of South Africa
PCAOB	Public Company Audit Oversight Board
Protection of Funds Act	Financial Institutions (Protection of Funds) Act 28 of 2001
RA	Registered Auditor
RiBS	Risk Based Supervision
SADC	South African Development Community
SAFCOM	Safex Clearing Company (Pty) Ltd
SAFIRES	South African Financial Instruments Real Time Electronic Settlement
SAIA	South African Insurance Association
SAICA	South African Institute of Chartered Accountants
SAPS	South African Police Services
SARB	South African Reserve Bank
SCCU	Special Commercial Crimes Unit at NPA
SENS	JSE Stock Exchange News Service
SMEs	Small and Medium-sized Enterprises
SMI	Small-Medium Impact
SRO	Self-Regulatory Organization
SSA	Securities Services Act 36 of 2004 (repealed)
Strate	Strate (Pty) Ltd
TRP	Takeover Regulation Panel
TSP	Trading Services Provider

## EXECUTIVE SUMMARY

**While South Africa's level of implementation of the International Organization of Securities Commissions (IOSCO) Principles is complete in several areas, there is room for enhancement.**

The legal framework is robust and provides the authorities with broad supervisory, investigative and enforcement powers. There are arrangements for on-site and off-site monitoring of regulated entities. The powers to cooperate with domestic and foreign counterparts are extensive. Accounting and auditing standards are high, as is the disclosure regime that applies to listed companies in practice. The market infrastructure is robust for the current, largely domestic, character of direct market participants.

**The securities regulatory structure is complex.** Responsibility is divided across several authorities with differing mandates and resources that report to two different government ministries. These same structural challenges are evident within the Financial Services Board (FSB), where supervision is divided on a sectoral basis that may not reflect the way some important market participants carry on business. The proposed twin peaks structure is expected to address at least some of this complexity. However, where responsibilities continue to be shared there is a potential for both gaps and duplication. The FSB should ensure that there is a common understanding among the relevant regulators of the scope, depth and focus of their supervision, particularly with the Johannesburg Stock Exchange (JSE) and the South African Reserve Bank (SARB).

**Some areas of supervision and enforcement require strengthening.** The FSB should ensure that the scope of regulation and intensity of supervision are more uniform across its divisions. In particular, the CIS framework is notably less comprehensive and intrusive than that in other areas. The disclosure regime for unlisted companies and CIS has substantive gaps, as do the CIS valuation and accounting standards. The capital and reporting requirements for financial services providers (FSPs) should be strengthened. The FSB should also pursue the use of all of its available enforcement authority, including by continuing to pursue more criminal prosecutions. Recent initiatives to build effective relationships with other responsible authorities should help in this regard.

**Certain aspects of the FSB's governance structure raise concerns about its independence, although there were no indications of any interference with its day-to-day operations.** The presence of industry members on certain Board Committees and the authority of the Minister of Finance to remove a Board or Executive Committee member for reasons other than misconduct or incompetence may be perceived as a threat to the FSB's independence. The government has recognized the need for greater regulatory independence, which is reflected in the governance models set out in the twin peaks bill. The independence of the Independent Regulatory Board for Auditors (IRBA) should also be strengthened.

## INTRODUCTION

**1. An assessment of the level of implementation of the IOSCO Objectives and Principles of Securities Regulation (IOSCO Principles) was conducted in South Africa from May 6 to 23, 2014.** The assessment was made as part of the IMF FSAP by Eija Holttinen, Monetary and Capital Markets Department, IMF and Tanis MacLaren, external expert working for the IMF. The previous IOSCO assessment of South Africa was conducted in 2010.

## INFORMATION AND METHODOLOGY USED FOR ASSESSMENT

**2. The assessment was made on the basis of the IOSCO Principles approved in 2010 and the Assessment Methodology adopted in 2011.** As has been the standard practice, Principle 38 was not assessed due to the existence of separate standards for securities settlement systems and central counterparties.

**3. The IOSCO Assessment Methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice.** The ongoing global financial crisis has reinforced the need for assessors to make a judgment about supervisory and other operational practices and to determine whether they are sufficiently effective. Among other things, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope and quality of inspections, as well as how the relevant authorities follow up on findings, including by using enforcement actions.

**4. The assessment was based on several sources.** These comprise (i) a self-assessment and additional written responses prepared by the authorities; (ii) reviews of the relevant legislation and regulations; (iii) meetings with the management and staff of the FSB, the Company and Intellectual Property Commission (CIPC), the IRBA, the National Prosecuting Authority (NPA) and the South Africa Police Services (SAPS); and (iv) meetings with market infrastructures and market participants, including the Johannesburg Stock Exchange (JSE), Strate (Pty) Ltd (Strate), the Association for Savings and Investment South Africa (ASISA), the Financial Intermediaries Association of Southern Africa, securities brokers, fund management companies, asset managers, issuers, an audit firm, and a credit rating agency (CRA).

**5. The assessors want to thank the South African authorities and market participants for their cooperation and willingness to share information.** The views of authorities and market participants on the current status and the best way forward for the regulation and supervision of the South African securities markets provided an essential input to the conclusions of the mission. In the organizational side, our particular thanks go to Annah Manganyi of the FSB.

# INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW

## A. Regulatory Structure

**6. The securities regulatory and supervisory responsibilities in South Africa are divided among several public authorities and market infrastructures.** While the FSB is responsible for supervising collective investment scheme (CIS) managers and exchanges, the supervisory responsibility for market intermediaries is divided between the FSB and the Johannesburg Stock Exchange (JSE). The FSB has no role in issuer supervision, which is undertaken by the JSE for listed companies and by the Department of Trade and Industry's (DTI) CIPC for unlisted companies. Audit oversight is the responsibility of IRBA. The functions and powers of the FSB and the Registrar are set out in the Financial Services Board Act (FSB Act) and in various sectoral Acts, such as the Financial Markets Act (FMA) and the Collective Investment Schemes Control Act (CISCA). In his capacity as the Executive Officer of the FSB, the Executive Officer acts as the Registrar of CIS, Securities Services, Credit Rating Agencies and Financial Services Providers under the respective sectoral Acts.

**7. In addition to the JSE, other market infrastructures are also obliged to undertake certain self-regulatory responsibilities under the FMA.** Strate, the South African central securities depository (CSD) for listed equity securities and government and corporate debt securities, is a market infrastructure licensed under the FMA. Two clearing houses have been licensed by the FSB: Strate (for bonds) and Safex Clearing Company (Pty) Ltd (SAFCOM) (for derivatives). The self-regulatory responsibilities of Strate are more limited than those of the JSE, and relate to monitoring and disciplining its participants' compliance with the FMA and its own rules and directives.<sup>1</sup>

**8. The CIPC and JSE share the responsibility for issuer regulation, supervision and enforcement.** The CIPC is responsible for the incorporation and registration of all companies (including listed and non-listed public companies) in South Africa. It is also responsible for monitoring public companies' compliance with the Companies Act disclosure requirements. The JSE through its Listing Requirements regulates initial and periodic disclosure requirements for listed issuers. The Takeover Regulation Panel (TRP), created by the Companies Act, has the authority to enforce South African laws concerning mergers, acquisitions and changes in corporate control. Under the Companies Act, the TRP is a separate body from the DTI with specified responsibilities.

**9. The South African Reserve Bank (SARB) has limited securities supervisory responsibilities.** Banks have to be authorized as financial services providers (FSPs), if they provide financial services requiring a license under the Financial Advisory and Intermediary Services Act (FAIS Act). In such cases the supervisory responsibilities are divided between the FSB and SARB, with the FSB being responsible for supervising and enforcing compliance with the FAIS Act. Investment

<sup>1</sup> SAFCOM does not have any self-regulatory responsibilities because it is an associated rather than an independent clearing house under the FMA (see Principle 9).

banks' merchant banking services to clients other than pension funds and natural persons have been exempted from the FAIS Act; as such, the SARB has regulatory responsibility for such exempted functions.

## New legislation

**10. Since the last IOSCO assessment, two new relevant Acts have come into force.** On June 3, 2013, the FMA replaced the Securities Services Act (SSA). The FMA primarily focuses on the licensing and regulation of market infrastructures (exchanges, CSDs, clearing houses and trade repositories) and on the prohibition of insider trading and other market abuses. Further, the FMA provides a framework for regulating over-the-counter (OTC) derivatives in South Africa under regulations that can be issued by the Minister of Finance. The Credit Rating Services Act (CRSA) came into effect on April 15, 2013. This Act introduced a framework for the registration and supervision of credit rating agencies in South Africa.

**11. The General Amendment Act,<sup>2</sup> which came into force on February 28, 2014 also introduced some relevant regulatory changes by amending all the Acts applicable to the FSB activities.** Among other changes, it aligned the supervisory powers of the Registrar, provided for enhanced protection of information and sharing of information provisions, clarified and extended the consumer education and protection mandate of the FSB, and extended the Registrar's powers to act swiftly to prevent the failure of any financial institution.

## B. Market Structure

### Market infrastructures

**12. The JSE is the only securities exchange in South Africa.** It is a public company listed on the JSE main list.<sup>3</sup> SAFCOM, a wholly-owned subsidiary of the JSE, clears JSE derivatives transactions. The JSE manages the pre-settlement process for equities trades and can require margin to cover open positions. Settlement of equity and bond trades takes place at Strate that is also the CSD for both markets. Strate is jointly owned by the JSE (44.6 percent) and the four largest South African banks each owning 12–15 percent.<sup>4</sup>

**13. Key market information on the most important products traded on the JSE is provided in the following table:**

<sup>2</sup> Financial Services Laws General Amendment Act 45 of 2013.

<sup>3</sup> Any holding in excess of 15 percent, but not exceeding 49 percent of the JSE share capital must be approved by the Registrar. A holding of more than 49 percent requires the approval of the Minister of Finance under Section 67(5)(a) of the FMA.

<sup>4</sup> In addition, Citibank owns 0.1 percent of Strate's shares.

**Table 1. Key Market Information**

	<b>12/2011</b>	<b>12/2012</b>	<b>12/2013</b>
<b>Shares</b>			
Number of listed shares	406	402	389
Market capitalization (billion USD)	1,175	988	1,015
Market capitalization as percent of GDP	191.3	267.09	291.97
Market capitalization of top 10 issuers (billion USD)	414	474	546
New listings	16	14	13
Annual turnover (billion USD)	454	419	409
Annual turnover of top 10 issuers (billion USD)	229	198	186
Average daily trading volume (number of shares)	287,019,977	247,374,883	255,567,541
Average daily turnover (million USD)	1,823	1,674	1,635
<b>Bonds</b>			
Number of listed bonds	135	152	133
Market capitalization (billion USD)	184	221	188
Market capitalization as percent of GDP	50.71	59.60	54.10
New listings	732	896	815
Annual turnover (billion USD)	2,883	2,801	2,001
Average daily turnover (million USD)	11,579	11,203	8,002
<b>Equity derivatives</b>			
Annual turnover (billion USD)	598	515	520
Average daily trading volume (number of contracts)	597,682	547,894	869,886
Average daily turnover (million USD)	2,400	2,061	2,078
Number of exchange members	126	126	120
<b>Interest rate and currency derivatives</b>			
Annual turnover (billion USD)	43	55	78
Average daily trading volume (number of contracts)	60,681	77,631	152,835
Average daily turnover (million USD)	171	220	314
<b>Commodity derivatives</b>			
Annual turnover (billion USD)	55	62	50
Average daily trading volume (number of contracts)	11,513	11,998	11,153
Average daily turnover (million USD)	219	249	201

Sources: FSB and JSE.

## JSE members

**14. The number of JSE members has remained stable over the past three years.** While the JSE Equities Rules limit the activities of equity members principally to trading on that market, the derivatives rules allow a broader range of members, including banks, asset managers and end-users.

**Table 2. Number of JSE Members by Market**

	2011	2012	2013
Equities	63	61	62
Equity Derivatives	126 (9)	126 (9)	120 (10)
Interest Rate and Currency Derivatives	98 (6)	98 (6)	102 (6)
Commodity Derivatives	100 (5)	100 (5)	92 (5)
Bonds	46	47	49

Source: JSE.

Note: Number of clearing members in each category shown in brackets; there are no clearing members on the Equities Market.

**15. Cross-border activities are limited.** Direct membership by foreign firms on the JSE is prohibited, but the most active equities trading members are subsidiaries of foreign investment banks. Foreign subsidiaries of member firms are not regulated by the JSE, so it does not have routine access to information on these activities. Local members do not appear to have significant operations abroad.

**16. The percentage of firms owned domestically other than by financial institutions is higher than in many jurisdictions.** Domestic private or listed companies own almost half the firms (48 percent). Only 25 percent are owned by domestic banks or insurance companies and 27 percent are owned by foreign banks or investment firms.

**Table 3. Ownership of JSE Equity Firms**

Ownership of JSE Equity Firms	Percentage of Firms
Local banking groups	19
Local listed companies	8
Local insurance groups	6
Local private ownership	40
Foreign banking groups	19
Foreign investment firms	8

Source: JSE.

## Other intermediaries

**17. The number of FSPs licensed under the FAIS Act has been stable over the past four years.** The only category where there has been any substantive change is Category I FSPs (chiefly advisers and financial planners), where the decline can be ascribed to consolidation and increasing costs of compliance.

**Table 4. Financial Services Providers Licensed under the FAIS Act (By Category)**

Category of Firm	Number of Firms as of March 31			
	2011	2012	2013	2014
Category I (Advisers and others)	11,322	10,333	10,164	10,152
Category II (Discretionary)	551	561	585	613
Category IIA (Hedge Fund)	117	118	117	113
Category III (Administrative)	23	22	24	27
Category IV	38	56	68	87
Total number of authorized firms	12,051	10,790	10,958	10,992

Source: FSB.

## CIS

**18. The fund management industry is significant with assets under management (AUM) reaching ZAR 1.5 trillion (USD 161 billion) at the end of 2013.** These AUM were managed by 48 fund managers in a total of 1,084 portfolios.<sup>5</sup> Money market funds (MMFs) play an important role at 17 percent of total AUM in local CIS. In addition, unregulated hedge funds manage approximately USD 10 billion of assets, primarily in trusts and partnerships. The development of the AUM of the South African regulated CIS in the past three years is presented in the following table.

**Table 5. Assets under Management in South African Collective Investment Schemes (Billion ZAR)**

	2011	2012	2013
South African Funds <sup>6</sup>	956	1,160	1,373
Equity	214	253	297
Multi-asset	283	394	627
Real Estate	32	47	48
Money Market	253	245	257
Other Interest Bearing	173	221	143
Other Funds	55	70	126
Total	1,011	1,230	1,499

Source: ASISA.

<sup>5</sup> Several portfolios may be managed under the same scheme.

<sup>6</sup> South African funds refer to funds that have invested their assets in South Africa.

## PRECONDITIONS FOR EFFECTIVE SECURITIES REGULATION

### 19. **The preconditions for effective securities regulation appear to be in place in South Africa.**

Foreign issuers can access the markets under similar conditions to domestic issuers, although this is infrequently done. The authorization process does not distinguish between domestic and foreign intermediaries that want to provide investment services.

### 20. **The companies legislation is modern and includes provisions pertaining to the management of the company, rights of shareholders, duties of directors and officers, preparation and audit of company accounts and proceedings of shareholder meetings.**

Public companies, whether listed or unlisted, are subject to additional requirements in many areas, such as the accounting standards that must be used. The companies legislation contains detailed rules governing takeovers and related significant transactions. These have the force of law and are administered by the TRP. It also governs the liquidation, winding up and restructuring of insolvent companies. New provisions were introduced in the companies legislation that are designed to facilitate restructuring the finances and operations of companies thereby avoiding liquidation. The Insolvency Act<sup>7</sup> is old, but has been updated to address issues such as the protection of customers' assets held by intermediaries and giving the exchange and clearing systems the ability to close out or unwind incomplete transactions on the insolvency of a market participant.

### 21. **There are dedicated independent tribunals and courts to deal with securities related matters.**

The judiciary's independence is protected by the Constitution. There are specialized tribunals to facilitate the resolution of disputes, particularly over the exercise of regulatory powers. There is also a specialized commercial crimes court in place.

### 22. **The accounting and auditing standards are of a high and internationally acceptable quality.**

All public companies, whether listed or unlisted, are required to prepare their financial statements in accordance with the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The International Standards on Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB) have been officially adopted.

## MAIN FINDINGS

### 23. **Principles for the regulator.**

The securities regulatory and supervisory responsibilities are defined in various Acts and allocated to several authorities and market infrastructures. This applies also within the FSB, where different Divisions led by Deputy Registrars operate fairly independently. The complex division of responsibilities may lead to regulatory gaps and inconsistencies.

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<sup>7</sup> Act No. 24 of 1936.

Supervisory cooperation is intended to reduce the risks from the current fragmented model, and includes monitoring systemic risk and assessing the regulatory perimeter. However, optimal structures are not yet in place. The FSB has sufficient powers, authority and funding to meet its responsibilities; ensuring sufficient staff expertise in the transition to the new twin peaks structure is a challenge. There may be, at a minimum, an appearance of undue political or commercial influence in the FSB decision-making due to the current ministerial appointment process and certain governance arrangements. Some FSB internal policies and practices require strengthening and harmonizing across the organization. There are requirements in place to address conflicts of interest of supervised entities.

**24. Principles for self-regulation.** The JSE and Strate are under statutory obligations to undertake certain important self-regulatory responsibilities. Intermediary activities covered by their supervision are exempt from supervision by the FSB. The FSB assesses their self-regulatory capacity and arrangements upon licensing and on an ongoing basis. Conflicts of interest between the JSE's and Strate's commercial and self-regulatory functions must be managed in a manner satisfactory to the FSB.

**25. Principles for enforcement.** The FSB has broad powers to inspect, investigate and conduct surveillance of securities markets and activities. It has comprehensive powers to take action against anyone who breaches the laws it administers. The FSB's risk-based system drives its supervisory program, which consists of off-site supervision and on-site inspections including full reviews, thematic reviews, and ad-hoc visits. The FSB's Enforcement Committee (EC) has wide powers to impose sanctions and has obtained significant monetary sanctions. All sanctions imposed by the EC are published as are most others imposed by the Registrars. Criminal cases have been referred for investigation and prosecution, but very few have led to convictions. The record-keeping requirements under CISCA are minimal and the depth of CIS supervisory activities could be enhanced.

**26. Principles for cooperation.** The FSB has the ability and capacity to share information and cooperate with other authorities domestically and internationally. It is a signatory to many Memoranda of Understanding (MOUs), including the IOSCO Multilateral MOU (MMOU) and a number of bilateral MOUs with its international counterparts, and has a record of active cooperation. It participates in several domestic supervisory colleges involving financial groups. It does not require the permission of any outside authority to share or obtain information, nor does it require an independent interest in the matter to assist.

**27. Principles for issuers.** The initial disclosure requirements for securities to be listed on the JSE are satisfactory, as are most of the continuous disclosure requirements. There are significant gaps in both the initial and continuous disclosure requirements applicable to unlisted public companies, such as no requirement to provide public disclosure of material changes or prepare interim financial statements. The reporting deadlines for financial statements are slow by international standards, although in practice JSE issuers report more promptly. Public company shareholders are treated equitably with respect to voting and the ability to participate in any takeover bid. Full information must be provided for any takeover bid and the price paid to

shareholders must be equivalent. There are extensive disclosure requirements for substantial shareholders, directors and other parties. All public companies in South Africa are required to prepare their financial statements in accordance with the IFRS as issued by the IASB. There are processes in place to review their financial statements to ensure standards are met.

**28. Principles for auditors, credit rating agencies, and other information service providers.**

IRBA supervises auditors of public companies. Its responsibilities include the registration, inspection, and discipline of auditors. IRBA's independence could be enhanced by a broadened funding model and limitations on the participation of auditors on its governance bodies. There are extensive requirements for auditors to be independent of the entities they audit; these requirements are enforced by IRBA. The financial statements of public companies must be audited in accordance with the ISA as issued by the IAASB. The regulatory framework for CRAs complies with international standards and the FSB is currently launching its CRA supervisory program. Analytical or evaluative service providers are not relied on and are not required to be authorized.

**29. Principles for collective investment schemes.** Regulatory requirements apply to registration of CIS managers and trustees and approval of the CIS deed. Regulation of conflicts of interest, record-keeping and conduct of business is insufficiently granular. The FSB's intensity of supervision on CIS managers and trustees would benefit from enhancement. CIS are subject to investment limits and restrictions and managers are required to segregate client assets and funds. Related party custody is prohibited in practice. Limited public disclosure requirements apply to CIS and accounting standards for CIS are not specified. Valuation of CIS assets is largely regulated in a very general manner, leaving significant room for discretion and placing the responsibility on appropriate valuations on trustees. MMFs apply constant net asset value (NAV), and permit longer maturity investments than recommended by IOSCO. Hedge fund regulation complies with IOSCO minimum requirements through requirements imposed on the hedge fund manager as an FSP.

**30. Principles for market intermediaries.** A framework is in place at the FSB and JSE for licensing and applying on-going requirements on market intermediaries. License applicants are subject to a detailed review process to ensure they are fit and proper. There are initial and ongoing capital requirements for all types of intermediaries. The JSE's capital formula is risk-based and timely reporting requirements apply. The JSE also directly monitors members' capital daily. While certain categories of FSPs are subject to higher minimum capital amounts, the capital formula that applies to FSPs is not sensitive to the full range of risks and focuses on solvency and liquidity. Routine reporting by these firms is limited. Market intermediaries are required to have risk management and internal control systems in place, but there is no requirement that these systems be reviewed on behalf of the firm by an objective party. Regulations address proper protection of clients, including requirements for business conduct and segregation of clients' assets. There is no written plan in place at the FSB or JSE for dealing with a firm failure, but each has extensive powers to intervene to protect clients and the market.

**31. Principles for secondary markets.** Exchanges are subject to comprehensive regulatory requirements as a condition for licensing and on an ongoing basis. The JSE, as the only exchange, is responsible for market surveillance and supervision of its members. The FSB performs detailed

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supervision of the JSE, conscious of the potential for regulatory capture arising from such close involvement. Sufficient pre- and post-trade transparency requirements apply under the JSE Rules. Insider trading, market manipulation and disclosure of false and misleading information are prohibited and subject to both administrative and criminal sanctions. Monitoring, investigations and enforcement require cooperation between several authorities. There has been only one criminal conviction for market abuse (fraud). The JSE closely monitors open positions in equity and derivatives markets and can take prompt action when needed. Covered short selling is permitted, but there are no disclosure requirements to the regulator or the market.

## SUMMARY IMPLEMENTATION OF THE IOSCO PRINCIPLES

**Table 6. Summary Implementation of the IOSCO Principles—Detailed Assessments**

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	PI	The FSB's and the Registrar's regulatory and supervisory responsibilities are set out in the FSB Act, the Protection of Funds Act, the Inspection Act and the various sectoral Acts. Legislation also assigns specific responsibilities to the FSB Directorate of Market Abuse (DMA) and EC. Under the FMA, market infrastructures (the JSE and Strate) have important self-regulatory responsibilities. The Registrar has a wide exemption power both generally and in relation to specific entities and activities; the exercise of this power is not uniformly transparent across the FSB. The regulatory treatment of economically equivalent products has until recently been subject to limited regulatory attention. Responsibilities for certain sectors—in particular market intermediaries and issuers—are assigned to multiple authorities, creating a complex regulatory system with potential for gaps and inconsistencies. Cooperation arrangements aim at ensuring coordination.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	PI	The Minister of Finance has extensive powers to appoint and remove the FSB Board, Appeal Board and DMA members and the majority of the Executive Committee members. The current appointment process may create, at a minimum, the appearance of indirect political influence in the FSB decision-making. Similar issues relate to industry representation in some of the Board Committees. The FSB is subject to sufficient accountability to the Parliament and the Minister of Finance. It publishes an annual report, but there is no FSB wide approach to the publication of supervisory and enforcement measures. The FSB is funded through fees and levies from supervised entities, and its budget is approved by its Board. However, the Minister of Finance approves the fees of the FAIS Registrar, constituting an important part of the overall FSB budget. There are immunity provisions in the FSB Act to protect the FSB and its staff. Appropriate administrative procedures are

Principle	Grade	Findings
		applied to supervisory and enforcement duties.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	BI	The FSB has sufficient powers, authority and funding to meet its responsibilities. While its staffing level is appropriate for its current functions, attracting and maintaining sufficient expertise in certain areas has been a challenge. The sectoral legislation assigns most of the decision-making powers to the Registrar. These powers are largely delegated to the Deputy Registrars and the Divisions managed by them, which has been conducive to a siloed approach to decision-making. Board Committees advise the Divisions in regulatory, enforcement and licensing decisions. The FSB is active in investor education.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	BI	Currently the sectoral Acts apply different requirements to the rulemaking processes, even though in practice approaches across Divisions have largely converged. A new framework governing the FSB's rule-making process, including stakeholder consultation and publication, is under preparation. Both the FSB and market infrastructures apply appropriate consultation practices in their regulatory processes. The public access to legislation and FSB regulatory measures is incomplete, due to the need to subscribe to a commercial service for full access and the structure of the FSB website.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	BI	The FSB Staff Code of Conduct provides a framework for dealing with staff conflicts of interest. Under their contracts of employment, FSB employees must not hold or trade the shares of regulated entities. The Staff Code of Conduct is less restrictive in this regard, and it does not apply to the FSB Board, Board Committee and DMA members. The Code of Conduct is enforced. Strict confidentiality provisions apply to the FSB staff and management.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to	PI	The FMA assigns specific responsibilities to the Registrar and the relevant market infrastructures for systemic risk monitoring and cooperation between the relevant authorities. Similar obligations are not included in the other Acts. The processes to monitor, mitigate and

Principle	Grade	Findings
its mandate.		manage systemic risk are currently being established and enhanced. They include bilateral cooperation between the FSB and SARB and the multilateral activities of the Financial Sector Contingency Forum (FSCF). This forum includes representation from the public sector and market infrastructures and participants. So far there have been limited discussions on systemic risk possibly arising from securities markets beyond trading and post-trading systems.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	BI	Reflecting the FSB's sectoral approach, the Divisions have primarily concentrated on their respective sectors when policing the regulatory perimeter. Lately, joint projects both within the FSB and between various authorities have been increasingly organized. However, the authorities are lacking a holistic process for reviewing the regulatory perimeter in relation to all products, entities and activities.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	BI	There are processes and requirements in place to address conflicts of interest and misalignment of incentives. The FSPs, JSE and JSE members, and Strate and Strate participants are subject to requirements on the avoidance, mitigation, management and disclosure of conflicts of interest.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	FI	The FMA assigns wide self-regulatory responsibilities to market infrastructures. As the JSE and Strate undertake these responsibilities, their members and participants are largely exempted from direct FSB supervision. The FSB assesses market infrastructures' self-regulatory capacity and arrangements, including through rule approval, reporting requirements, review of the JSE and Strate self-assessments and on-site visits. The JSE and Strate are subject to similar professional standards and procedural requirements as the FSB. There are specific requirements for managing the conflicts of interest between their commercial and self-regulatory functions.

<b>Principle</b>	<b>Grade</b>	<b>Findings</b>
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	BI	The FSB has broad powers to inspect, investigate and conduct surveillance of securities markets and activities. The record-keeping requirements under CISCA are minimal.
Principle 11. The Regulator should have comprehensive enforcement powers.	FI	The FSB has comprehensive powers to investigate and take action against anyone who breaches the legislation it administers. It also has powers to take action against FSPs for non-compliance with other laws.
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	BI	The FSB has a risk-based supervisory program, which consists of off-site supervision and on-site inspections including full reviews, thematic reviews, and ad-hoc visits. The EC has wide powers to impose sanctions and has proved successful in obtaining monetary sanctions, largely through settlements. All sanctions imposed by the EC are published as are most others imposed by the Registrars. Some criminal matters have been referred for investigation and prosecution, but very few have led to convictions.
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	FI	The FSB has the ability and capacity to share information and cooperate with other authorities domestically and internationally. It can share confidential information with any other authority and has a record of active cooperation.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.	FI	The FSB is a signatory to many MOUs, including the IOSCO MMOU and a number of bilateral MOUs with its international counterparts. It participates in several domestic supervisory colleges involving financial groups.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the	FI	The FSB has shared information under the IOSCO MMOU. It does not require the permission of any outside authority to share or obtain information, nor does it require an independent interest in the matter to assist.

Principle	Grade	Findings
discharge of their functions and exercise of their powers.		
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	PI	The initial disclosure requirements for a public offer of securities to be listed on the JSE are satisfactory, as are most of the continuous disclosure requirements thereafter. There are significant gaps in both the initial and continuous disclosure requirements applicable to unlisted public companies, such as no requirement to provide interim financial statements or make public disclosure of material changes. Unlisted entities (other than companies and CIS) offering their securities to the public do not appear to be required to make any disclosure, either initially or thereafter. The reporting deadlines for public company financial statements are slow by international standards, although in practice JSE issuers report more promptly.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	FI	Public company shareholders are treated equitably with respect to voting and the ability to participate in any takeover bid. Full information must be provided for any takeover bid and the price paid to shareholders must be equivalent. There are extensive disclosure requirements for substantial shareholders, directors and other parties.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	FI	All public companies in South Africa are required to prepare IFRS compliant financial statements. The JSE has a process in place to review the listed company financial statements to ensure accounting standards are met. The CIPC has started a similar program for unlisted public companies. The IRBA also conducts periodic reviews.
Principle 19. Auditors should be subject to adequate levels of oversight.	PI	Auditors of public companies are subject to appropriate oversight. Auditors must register with the IRBA, a statutory body. Its responsibilities include registration, inspection, and discipline of auditors, as well as setting standards of professional competence, ethics, and conduct. Its independence from the profession could be strengthened. The resources at IRBA are not sufficient for the tasks assigned.
Principle 20. Auditors should	BI	There are extensive requirements for auditors to be

Principle	Grade	Findings
be independent of the issuing entity that they audit.		independent of the entities they audit. These requirements are enforced by IRBA. However, the obligations to disclose promptly a change of auditor are incomplete.
Principle 21. Audit standards should be of a high and internationally acceptable quality.	FI	The financial statements of public companies must be audited in accordance with the ISA as issued by the IAASB.
Principle 22. 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.	BI	Credit ratings used for regulatory purposes must be issued or endorsed by authorized domestic or foreign CRAs. The CRSA and the Credit Rating Agency Rules implement the IOSCO Code of Conduct Fundamentals for CRAs. Four CRAs have been registered in South Africa, the last two in early May 2014. The FSB is implementing its supervisory plan.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	BI	Analytical or evaluative service providers are not relied upon to any significant degree. Research reports generally are issued only by JSE member firms, have limited circulation and limited impact in the jurisdiction. The provision of research alone would not constitute 'advice' under the FAIS Act or JSE Rules and therefore would not require specific authorization.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a CIS.	PI	CIS managers and trustees have to be registered under CISCA, and the Registrar verifies that CIS asset managers have been authorized under the FAIS Act. The registration of the CIS manager is conditional on the Registrar approving the CIS deed and any supplemental deeds. The FSB's powers to supervise delegated activities were recently enhanced. Regulation of conflicts of interest, record-keeping and conduct of business is insufficiently granular. While CIS managers are subject to regular on-site visits, the depth of the reviews is not comparable to those applied to other FSB supervised

Principle	Grade	Findings
		entities. The FSB has not conducted on-site reviews of trustee activities.
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	BI	CISCA does not require any particular legal form for a CIS, but in practice all of them are unit trusts. Any changes to the deed are notified to investors as part of the requirement to obtain approvals for deed amendments. CIS are subject to investment limits and restrictions. CISCA includes segregation requirements for client assets and funds. The Registrar does not in practice permit a CIS manager's related party to act as the trustee of its CIS, although CISCA does not appear to extend the prohibition beyond the manager's parent company and subsidiaries. There are no specific requirements on the use of sub-custodians beyond the trustee maintaining full responsibility for delegated activities.
Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a CIS for a particular investor and the value of the investor's interest in the scheme.	NI	There are very limited disclosure requirements for other CIS than CIS in property that are all listed and subject to the JSE requirements. For others, the deed provides some information required under Principle 26 following a standard template, but it is not required to be publicly disclosed. For non-listed CIS, there is currently no requirement for an offering document or equivalent, and managers of CIS in securities have been exempted from the CISCA content requirements for advertisements and the need to lodge advertisements with the Registrar. No specific accounting standards apply to CIS. Investors are required to receive an annual portfolio report.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a CIS.	NI	The requirements for valuing CIS assets are largely very general, and do not sufficiently address a situation where liquid market prices are not available. The deed is required to include only very limited provisions on how the CIS assets are to be valued. The trustee is obliged to ensure that unit prices are calculated in accordance with CISCA and the deed. MMF assets are valued at amortized cost, and the maximum maturities permitted for MMF assets are longer than recommended by IOSCO. CISCA requires CIS units to be subscribed and redeemed at unit NAV, and the circumstances enabling the suspension of

Principle	Grade	Findings
		redemptions are prescribed. There are no regulatory requirements on pricing errors.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	FI	The regulation of hedge funds currently relies on requiring the hedge fund asset manager to be authorized as an FSP. This complies with the IOSCO minimum requirement, although the hedge funds themselves are not regulated and there are no specific requirements on hedge fund administration. As FSPs, hedge fund managers are subject to sufficient prudential, conflict of interest and client asset protection requirements. They are supervised following the general risk-based approach to FSP supervision. Hedge fund investor disclosure requirements are prescribed.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	FI	A framework is in place at the FSB for licensing and to apply on-going requirements for market intermediaries under the FAIS Act. Applicants are subject to detailed off-site reviews before licensing. On-site visits are routinely performed as part of the authorization process for the higher risk categories. The JSE has similar processes and standards in place for applicants and members.
Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	PI	There are initial and ongoing capital requirements for all types of intermediaries. The capital formula that applies to JSE members is based on the EU Capital Adequacy Directive and extensive timely reporting requirements apply. The JSE also directly monitors equities members' capital daily. The capital formula for FSPs is insufficiently risk-sensitive and focuses on solvency and liquidity. Certain categories of FSPs are subject to higher minimum amounts but these amounts do not vary based on the nature or size of positions. Routine reporting by these firms is limited.
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and	BI	Market intermediaries are required to have risk management and internal control systems. FSPs and JSE members' auditors are required to report annually on the treatment of client assets at the firm. Otherwise there is no compulsory review on behalf of the firm of the internal controls by an objective party. There are

Principle	Grade	Findings
operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.		regulations for proper protection of clients, including requirements for segregation of clients' assets and business conduct rules, such as know your client and suitability. The rules regarding conflicts of interest and protection of client assets are extensive.
Principle 32. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	BI	There is no written plan at the FSB for dealing with a failure of an FSP. However, the FSB has extensive powers to restrain conduct, to ensure clients' assets are properly managed and to obtain relevant information. It has the authority to go to court to expeditiously appoint a curator for the insolvent firm. It has used these powers in practice. The JSE has no plan, but has extensive powers to deal with a failure. There are guarantee funds available in the event of losses at JSE member firms, but not for FSPs. FSPs are required to maintain professional indemnity and fidelity insurance. Where a failure has cross-border implications, information sharing MOUs are in place.
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	FI	Exchanges are required to be licensed, and the licensing criteria and process are set in detail in the FMA and a Board Notice. The only licensed exchange is the JSE, but the Registrar is analyzing some trading platforms operated by public companies making a market in their own shares to determine whether they should be licensed.
Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different	FI	The JSE is responsible for market surveillance and supervising its members' compliance with the FMA, the JSE Rules and the JSE Directives. The FSB itself does not conduct real-time market surveillance, but regularly reviews trading in JSE shares. It investigates improper market conduct referred by the JSE. The FSB attends all JSE Board, Board Committee and Advisory Committee meetings and reviews documents, reports and the JSE yearly self-assessment. On-site visits are also conducted. The FSB is conscious of the potential for regulatory

Principle	Grade	Findings
market participants.		capture arising from its close involvement with the JSE.
Principle 35. Regulation should promote transparency of trading.	FI	Sufficient pre- and post-trade transparency is required by the JSE Equities Rules. The rules contain limited exceptions on pre-trade transparency for hidden orders and certain off-order book trade types that comply with specific conditions. According to the JSE, most equities trading is undertaken through the central order book. All trades, including off order book ones, are subject to immediate post-trade transparency.
Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	BI	Insider trading, market manipulation and disclosure of false or misleading information are prohibited in the FMA. A front running prohibition applies to FSPs, whereas front running by exchange members is not specifically addressed. Market abuse is subject to both administrative and criminal sanctions. The potential for market abuse is monitored by the JSE that refers any suspicious activity to the FSB. Decisions on investigations and administrative enforcement actions are taken by the DMA and EC, respectively. Administrative sanctions have been imposed, but there has been only one criminal conviction for market abuse.
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	BI	The JSE closely monitors open positions in both equity and derivatives markets, and can take various actions, if a member is not able to meet its settlement obligations or post required margin. Default procedures are in place and disclosed through the JSE rules. Naked short selling is prohibited, and covered short selling is defined narrowly. There are no reporting requirements to the JSE, FSB or the market on short selling, and the JSE and the FSB do not undertake any particular surveillance of short selling.
Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA)		

## RECOMMENDED ACTION PLAN AND AUTHORITIES' RESPONSE

**Table 7. Recommended Action Plan to Improve Implementation of the IOSCO Principles**

Principle	Recommended Action
Principle 1	<ul style="list-style-type: none"> <li>• The authorities should ensure that the future legislation applicable to the new twin peaks structure harmonizes the regulatory, supervisory and enforcement responsibilities and powers across the sectors. The consistent implementation of these powers and responsibilities should be supported by an appropriate organizational structure and processes.</li> <li>• The FSB should ensure that sufficiently harmonized regulatory requirements are applied to economically equivalent products.</li> <li>• The FSB should make information on all the exemptions granted available on the official website, as required by Section 21 of the FSB Act.</li> </ul>
Principle 2	<ul style="list-style-type: none"> <li>• The authorities should ensure that the upcoming twin peaks legislation and the governance arrangements of the conduct and prudential authorities provide sufficient political and commercial independence to them. This includes introducing clear limitations on the reasons for the removal of the members of the authorities' relevant governance bodies.</li> <li>• The government should remove the requirement for the Minister of Finance to approve the fees charged under the FAIS Act.</li> <li>• The FSB should develop an FSB wide policy for the publication of supervisory and enforcement measures.</li> </ul>
Principle 3	<ul style="list-style-type: none"> <li>• The authorities should ensure that the future twin peaks legislation and its implementation within the conduct authority support a more coordinated approach to supervision and decision making than currently.</li> <li>• The FSB should seek to maintain and attract sufficient expertise to the authority.</li> </ul>
Principle 4	<ul style="list-style-type: none"> <li>• The authorities should ensure that the code of norms and standards under section 18(3) of the FSB Act is finalized and published as soon as possible.</li> <li>• The authorities should harmonize the current requirements for the</li> </ul>

Principle	Recommended Action
	<p>FSB's rule-making processes across the various sectors. The processes should include appropriate, harmonized approaches to assessing the cost of compliance with regulation.</p> <ul style="list-style-type: none"> <li>The FSB should improve public access to legislation and to its own regulatory measures by posting copies on the FSB website in an easily identifiable location and removing the need to subscribe to a commercial service.</li> </ul>
Principle 5	<ul style="list-style-type: none"> <li>The FSB should align the requirements for the holding of and trading in securities in the contract of employment and Staff Code of Conduct and ensure that the restrictions apply to all securities, not only shares.</li> <li>The FSB should apply appropriate securities holding and trading restrictions to all persons that may have access to confidential supervisory information, such as the FSB Board, Board Committee and DMA members.</li> </ul>
Principle 6	<ul style="list-style-type: none"> <li>The FSB should develop holistic, organization wide arrangements for monitoring, mitigating and managing systemic risk possibly arising from securities markets, ensuring that the approach extends beyond the current focus on trading and post-trading systems.</li> <li>The FSCF, FSOC and any dedicated macroprudential function to be established in the future should ensure that they adopt and maintain a broad approach to analyzing systemic risks, ensuring that those possibly arising from securities markets are sufficiently covered.</li> </ul>
Principles 7, 8 and 23	<ul style="list-style-type: none"> <li>The authorities should ensure that there is a sufficiently holistic process in place to ensure that products, entities and activities do not inadvertently fall outside the regulatory perimeter as a result of the current complex division of regulatory and supervisory responsibilities.</li> <li>The FSB should consider putting in place an FSB-wide pro-active process to survey the marketplace to ensure issues of concern, such as emerging conflicts of interest, are identified and addressed early.</li> <li>The FSB should ensure that the role of analysts and providers of other evaluative services is part of the overall perimeter of regulation review process.</li> </ul>
Principle 10	<ul style="list-style-type: none"> <li>The authorities should consider imposing more detailed record-keeping requirements for CIS managers.</li> </ul>

Principle	Recommended Action
	<ul style="list-style-type: none"> <li>The CIS Registrar should have the same authority to demand any information from CIS managers as is in place under the FMA and FAIS Act, and CISCA should be amended accordingly.</li> </ul>
Principle 11	<ul style="list-style-type: none"> <li>The FSB should ensure that the sanction publication practices of the CIS Division are aligned with those of other Divisions.</li> </ul>
Principles 12 and 24	<ul style="list-style-type: none"> <li>The FSB, and particularly its Enforcement Unit, should continue to work on building cooperative arrangements with the criminal enforcement authorities.</li> <li>The Registrar of CIS should enhance the depth of the on-site visits in CIS managers to align the approach with the processes applied by other Registrars and conduct on-site visits in CIS trustees.</li> </ul>
Principles 16, 18 and 20	<ul style="list-style-type: none"> <li>The government should amend the Companies Act provisions to shorten the deadline for publishing audited annual financial statements to 120 days or less. The Companies Act should also be amended to require publication of interim financial statements at least semi-annually, within a reasonable period after the period end.</li> <li>The government should amend the Companies Act to require public companies to make prompt public disclosure of material changes, including a change in auditor.</li> <li>The JSE is encouraged to make the de facto 90-day deadline for audited financial statements a firm requirement. It should consider whether the Alt<sup>x</sup> issuers should adhere to the same time frame or be given somewhat longer.</li> <li>The JSE should also consider shortening the reporting period for interim statements of JSE companies; 60 days or less is a more common period for main listings on major exchanges.</li> </ul>
Principle 19	<ul style="list-style-type: none"> <li>The government should expand the IRBA's authority to share information, particularly on a proactive basis with other regulators.</li> <li>The government should consider enhancing the independence of IRBA by amending its funding model to include additional sources, such as levying a fee on public companies.</li> <li>The authorities should consider reducing the participation of registered auditors (RAs) on IRBA committees responsible for investigations and disciplinary matters.</li> <li>The government should include provisions permitting the IRBA to</li> </ul>

Principle	Recommended Action
	indemnify directors and staff for their legal costs.
Principle 22	<ul style="list-style-type: none"> <li>The FSB should fully implement its supervisory plan, by conducting sufficient on-site visits and other ongoing supervision of credit rating agencies.</li> </ul>
Principle 24	<ul style="list-style-type: none"> <li>The FSB should significantly enhance the conflict of interest, record-keeping and conduct of business requirements applicable to CIS managers, in line with the requirements of the IOSCO Assessment Methodology and those that apply to other sectors.</li> </ul>
Principle 25	<ul style="list-style-type: none"> <li>The government should clarify the drafting of the prohibition of related party custody to ensure that all related companies are excluded from providing trustee services to a CIS manager.</li> <li>The authorities should consider the need to enhance the requirements for the use of sub-custodians.</li> </ul>
Principle 26	<ul style="list-style-type: none"> <li>The authorities should expeditiously:</li> <li>Require an offering document for all CIS;</li> <li>Require CIS accounts to be prepared in accordance with high quality, internationally acceptable accounting standards;</li> <li>Require the use of standard formats for CIS initial and periodic disclosures to investors; and</li> <li>Ensure they apply sufficient requirements to be able to identify inaccurate, false or misleading advertisements.</li> </ul>
Principle 27	<ul style="list-style-type: none"> <li>The authorities should significantly enhance the regulatory requirements on the valuation of all types of CIS assets and determine the high quality accounting standards to be used in such valuations.</li> <li>The FSB should consider, whether constant NAV MMFs may be converted to floating/variable NAV funds. Alternatively, the FSB should introduce additional safeguards as recommended by IOSCO to continue to permit the use of constant NAV.</li> <li>The authorities should ensure that there are sufficient regulatory requirements for the disclosure of CIS unit prices and the frequency of calculating the CIS NAV. Treatment of pricing errors should be subject to explicit regulatory requirements.</li> </ul>
Principle 30	<ul style="list-style-type: none"> <li>The FSB should adopt a more risk-sensitive capital formula for FSPs</li> </ul>

Principle	Recommended Action
	<p>that varies directly based on the risks undertaken by the firm, with riskier activities and securities and larger positions attracting higher initial and on-going capital requirements, regardless of the FSP's licensing category. Exposures to all related companies should be deducted when calculating capital.</p> <ul style="list-style-type: none"> <li>• The FSB should require FSPs to update their accounting records on a more timely basis. More frequent capital reporting should be required of all FSPs, except those that only carry on limited activities, such as advising only.</li> <li>• The FSB should consider including a new early warning obligation on FSPs to give immediate notice to the FSB when the firm's capital has declined below an early warning threshold, such as 10 percent over the minimum required, or there has been any other material adverse change in or threat to its financial position.</li> <li>• The JSE should consider amending its capital requirements to address exposures of the firm to off-balance sheet transactions and to any related company.</li> </ul>
Principle 31	<ul style="list-style-type: none"> <li>• The FSB and JSE should require FSPs and members to have a periodic review of their internal controls and risk management conducted by someone who can render an independent assessment, preferably an external expert such as an auditor.</li> <li>• The FSB and JSE should examine the division of responsibility for the supervision of JSE members that are also FSPs to ensure there is a common understanding of their respective responsibilities and that there are no gaps in or duplication of efforts in that supervision.</li> <li>• The FSB and JSE should routinely share inspection reports regarding firms that are JSE members and FSPs.</li> <li>• The FSB and JSE should consider requiring firms to put in place written account agreements for all accounts.</li> </ul>
Principle 32	<ul style="list-style-type: none"> <li>• Each of the FSB and JSE should have written plans in place outlining what actions will be taken (and by whom), if and when one of their respective regulated entities is in financial difficulty.</li> </ul>
Principle 36	<ul style="list-style-type: none"> <li>• The FSB, the SAPS and the NPA should continue to work towards the objective to enhance the use of criminal enforcement to combat market abuse.</li> <li>• The government is encouraged to consider extending the</li> </ul>

Principle	Recommended Action
	prohibition of insider trading to unlisted derivatives that have a listed security or derivative as an underlying instrument.
Principle 37	<ul style="list-style-type: none"> <li data-bbox="540 386 1390 457">• The JSE and/or the FSB should introduce a short selling reporting regime and increase the monitoring of short selling activities.</li> </ul>

## A. Authorities' Response to the Assessment

32. National Treasury would like to express its appreciation for the report on the detailed assessment of the IOSCO objectives and principles of securities regulation. South Africa finds the report very comprehensive and believes it displays a good understanding of the FSB and other regulators and market infrastructure responses. In our view the report is balanced, constructive and contains sections that are useful for purposes of future improvements on the areas that have been identified for enhancement. Of course the enhancement measures may take various other forms not necessarily mentioned in the report. South Africa has not questioned any of the ratings, but has provided comments for consideration on certain principles. Our supervisor, the FSB has raised with the FSAP team concerns about possible lack of consistency in the assessment methodology of principles between the 2008 and 2014 FSAPs. In particular, the document makes specific reference to the CIS assessments, where there had been downgrades even though neither the principles nor the legislation and practice changed over the 6 year period. It could be argued that had the grading in 2008 been similar to 2014, measures would have been put in place to address the shortcomings.

## DETAILED ASSESSMENT

**33. The purpose of the assessment is primarily to ascertain whether the legal and regulatory securities markets requirements of the country and the operations of the securities regulatory authorities in implementing and enforcing these requirements in practice meet the standards set out in the IOSCO Principles.** The assessment is to be a means of identifying potential gaps, inconsistencies, weaknesses and areas where further powers and/or better implementation of the existing framework may be necessary and used as a basis for establishing priorities for improvements to the current regulatory scheme.

**34. The assessment of the country's observance of each individual Principle is made by assigning to it one of the following assessment categories: fully implemented, broadly implemented, partly implemented, not implemented and not applicable.** The IOSCO assessment methodology provides a set of assessment criteria to be met in respect of each Principle to achieve the designated benchmarks. The methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the Principles in many different ways.

- A Principle is considered **fully implemented** when all assessment criteria specified for that Principle are generally met without any significant deficiencies.
- A Principle is considered **broadly implemented** when the exceptions to meeting the assessment criteria specified for that Principle are limited to those specified under the broadly implemented benchmark for that Principle and do not substantially affect the overall adequacy of the regulation that the Principle is intended to address.
- A Principle is considered **partly implemented** when the assessment criteria specified under the partly implemented benchmark for that Principle are generally met without any significant deficiencies.
- A Principle is considered **not implemented** when major shortcomings (as specified in the not implemented benchmark for that Principle) are found in adhering to the assessment criteria specified for that Principle.
- A Principle is considered **not applicable** when it does not apply because of the nature of the country's securities market and relevant structural, legal and institutional considerations.

**Table 8. Detailed Assessment of Implementation of the IOSCO Principles**

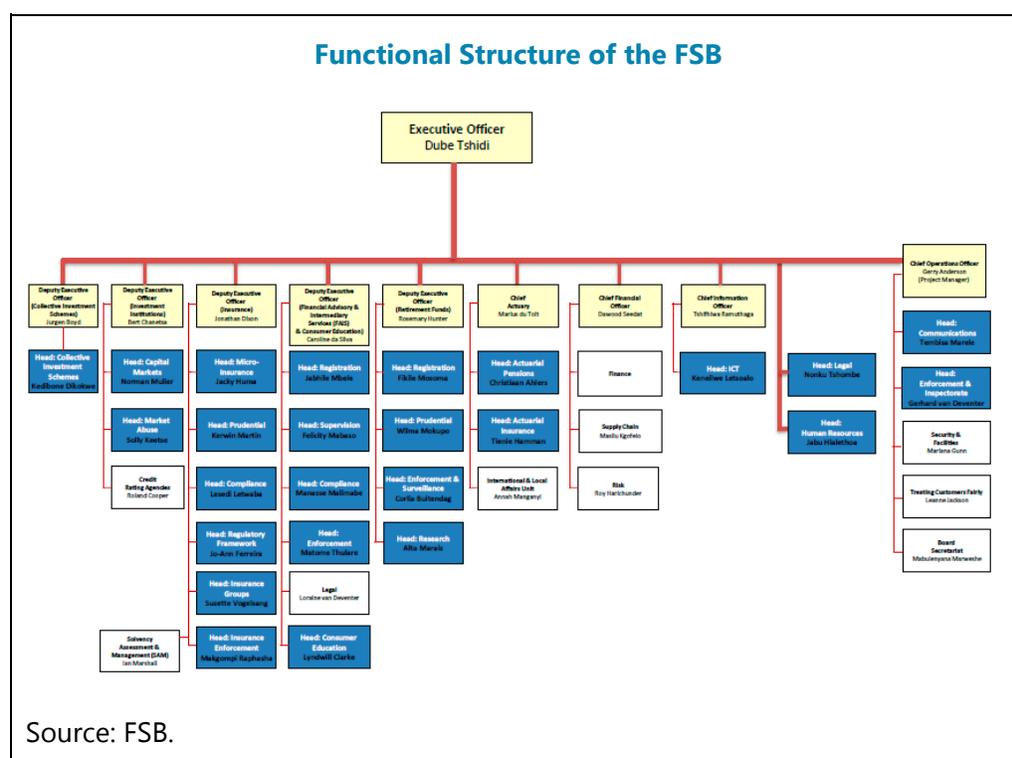
<b>Principles for the Regulator</b>	
<b>Principle 1.</b>	The responsibilities of the regulator should be clear and objectively stated.
Description	<p><b>Responsibilities and powers</b></p> <p>As described in the introduction, the FSB is the main supervisory authority in South Africa in the areas covered by the IOSCO Principles. Therefore the discussion in Principles 1-5 focuses on the FSB.<sup>8</sup></p> <p>The functions of the FSB are defined in Section 3 of the FSB Act as follows:</p> <ul style="list-style-type: none"> <li>• Supervise and enforce compliance with laws regulating financial institutions and the provision of financial services;</li> <li>• Advise the Minister of Finance on matters concerning financial institutions and financial services, either of its own accord or at the request of the Minister of Finance; and</li> <li>• Provide, promote or otherwise support financial education, awareness and confidence regarding financial products, institutions and services.</li> </ul> <p>Certain additional, specific powers of the FSB are included in Section 19 of the FSB Act, Section 26 of the FAIS Act and Section 24 of the CRSA (in relation to rule making) as well as Section 84 of the FMA (in relation to market abuse supervision and investigations). However, most of the responsibilities and powers are not assigned to the FSB as an institution, but either to the relevant Registrar under each sectoral Act or the special bodies established under the Acts applicable to the FSB's activities.</p> <p>In its functions, the FSB is assisted by an Executive Officer, one or more Deputy Executive Officers and a Chief Actuary; persons appointed by the FSB; and officers and employees placed at the disposal of the FSB. The Executive Officer performs the functions entrusted to him/her in the FSB Act or any other Act. (Section 13 FSB Act). On the basis of the various sectoral Acts, the Executive Officer also acts in the capacity of Registrar as follows (as relevant for the scope of the IOSCO Principles):</p> <ul style="list-style-type: none"> <li>• Registrar of Financial Services Providers (Section 2(1) FAIS Act);</li> <li>• Registrar of Collective Investment Schemes (Section 7(1) CISCA);</li> <li>• Registrar of Securities Services (Section 6(1) FMA; and</li> <li>• Registrar of Credit Rating Agencies (Section 21 CRSA).</li> </ul>

<sup>8</sup> The responsibilities, powers, independence and accountability of IRBA have been discussed in Principle 19, while the self-regulatory role of the market infrastructures has been addressed in Principle 9. The role of the CIPC and TRP are described in Principles 16 and 17, respectively.

The powers and functions of the Registrar are set out in the above-mentioned sectoral Acts (see in particular Section 4 FAIS Act, Sections 14–23 CISCA, Sections 6 and 94–97 FMA, and Sections 23–28 CRSA). In addition, the power of the Registrar to conduct on-site visits and to instruct an inspector to conduct an inspection are stipulated in Chapter 1A of the Financial Institutions (Protection of Funds) Act 28 of 2001 (Protection of Funds Act) and Inspection of Financial Institutions Act 80 of 1998 (Inspection Act), respectively.

Section 10(3) of the FSB Act requires the establishment of an EC to be responsible for hearing matters and issuing sanctions for the purposes of enforcing compliance with the laws regulating financial institutions and the provision of financial services. In addition, Chapter 2 of the Protection of Funds Act provides the Registrar with wide enforcement powers, including referral to the Enforcement Committee, vis-à-vis all financial institutions (see Principle 11).<sup>9</sup>

In addition, the DMA exercises certain powers to investigate and institute proceedings under Section 85 of the FMA (see Principles 11, 12 and 36).



The organization of the FSB reflects the legislative structure and the assignment of powers to the Registrar. More specifically, the Collective Investment Schemes Division in practice undertakes the responsibilities of the Registrar of CIS and the Financial Intermediary and Advisory Services and Consumer Education Division is in charge of

<sup>9</sup> The FMA and CRSA include a specific reference to the Enforcement Committee, but the FAIS Act and CISCA do not.

those assigned to the Registrar of FSPs. The Capital Markets Department undertakes the functions of the Registrar of Securities Services, while those of the Registrar of Credit Rating Agencies are the responsibility of the Credit Rating Agency Unit. The Market Abuse Department provides support to the DMA.

### **Interpretation of authority**

The South African constitution includes the principle of legality, which requires that powers are exercised in accordance with the statutory powers provided. In instances where laws provide for the exercise of discretionary powers, the FSB often formulates circulars or guidance notes on the interpretation of the statutory provisions. The FSB provides the industry an opportunity to comment on the draft circulars and guidance notes before they are published.

The Minister of Finance or the Registrar has the power to exempt certain persons or categories of persons from the application of the FAIS Act (Section 44), Cisca (Section 22), FMA (Section 6(3)(m)) and CRSA (Section 27). The Registrar can also exempt regulated entities from certain specific requirements, as provided in the various Acts. Under all the above-mentioned sectoral Acts, the Registrar may also issue directives that apply either generally or are limited in their application to a particular person or service or to a category of persons or services.<sup>10</sup>

Section 6(5) of the FMA includes a specific requirement for the Registrar to publish its directives<sup>11</sup> in the Gazette and on the official website and to table a copy of the published exemptions or directives in the Parliament, if they apply to all persons, regulated persons or securities services generally. A similar requirement applies under Section 27(4) of the CRSA, which requires the Registrar to publish an exemption that applies generally or to a type of registered CRA in the Gazette and through any other media that the Registrar deems appropriate. Under Section 26(5) of the CRSA, the Registrar must also publish a directive in the same manner, if it is issued to ensure the protection of investors, potential investors or the public in general. Copies of the published directives and exemptions must be submitted to the Parliament. Under Section 44(4)(a) of the FAIS Act, the Registrar may on reasonable grounds, on application or on the Registrar's own initiative by notice on the official web site, exempt any person or category of persons from any provision of the Act. Cisca also enables the Registrar to provide various exemptions, only some of which have to be published in the Gazette.

<sup>10</sup> The power to issue enforceable directives was introduced in the General Amendment Act that came into force on February 28, 2014.

<sup>11</sup> A direct reference to the requirement to publish an exemption is not included in Section 6(5).

Section 21 of the FSB Act requires that the annual report of the Board includes a list of all directives and exemptions issued under the FSB legislation<sup>12</sup> during the reporting period and that the directives and exemptions must be available on the official web site. Since this requirement was introduced only in the General Amendment Act, no such list has yet been published. Neither has the requirement to have all exemptions available on the official website been applied to all the CISCA exemptions.

### **Consistency of regulation**

The FSB is working to align the conduct requirements prescribed for different regulated entities, e.g., the proposed draft codes of conduct for authorized users regulated under the FMA and the financial services providers (FSPs) regulated under the FAIS Act. A similar approach has not been applied to product regulation, i.e., the regulatory frameworks for substantially similar products have not been coordinated. This reflects the fact that the product regulatory responsibilities are divided between several authorities, including the FSB, CIPC and JSE (see below). Within the FSB, different Registrars are also responsible for regulating different financial products that may be similar in economic terms (such as a CIS and a unit linked insurance plan).

### **Division of responsibilities between the FSB, the SARB and market infrastructures**

#### *FSB and SARB*

Banks have to be authorized as FSPs, if they provide financial services requiring authorization under the FAIS Act (see Principle 29).<sup>13</sup> In such cases the supervisory responsibility is divided between the FSB and the SARB. Investment banks' merchant banking services to clients other than pension funds and natural persons have been exempted from the FAIS Act. As such, the SARB has sole regulatory responsibility for such exempted services.

#### *FSB and market infrastructures*

The FAIS Act does not apply to authorized users (exchange members), CSD participants and clearing members (Section 45(1)(a)(i) FAIS Act). The responsibility for their regulation, supervision and enforcement has been assigned to the exchanges, CSDs and independent clearing houses in the FMA.

The JSE is responsible for authorizing its members, as well as regulating, supervising and enforcing their compliance with the exchange rules and directives (See Principles

<sup>12</sup> Financial Services Board legislation in this report (consistently with the definition in Section 1 of the FSB Act) refers to any relevant sectoral Act, the Inspection of Financial Institutions Act and the Financial Institutions (Protection of Funds) Act.

<sup>13</sup> Similar situation does not arise between the JSE and the SARB, because the JSE requires its members to be separately capitalized. Due to this, banks conduct their brokerage activities through separate subsidiaries.

9 and 29-31). If a JSE member conducts activities under the FAIS Act that are not covered by the JSE Rules, the FSB is responsible for supervising those activities.<sup>14</sup> As a licensed CSD, Strate is responsible for authorizing its participants and supervising their compliance with its rules and directives.<sup>15</sup> Since SAFCOM is an associated (rather than independent) clearing house and all its clearing members are JSE members, it does not have any supervisory and enforcement responsibilities in the manner an independent clearing house would have (see Principle 9). These responsibilities are undertaken by the JSE.

The JSE is solely in charge of supervising listed issuers' compliance with the JSE disclosure requirements (the FSB performs this role for JSE shares) (see Principle 16). The JSE also has primary responsibility for ongoing market surveillance (except for the trading in its own shares, which is the responsibility of the FSB), while the FSB is responsible for investigating and enforcing market abuse violations (see Principles 11, 12, and 36).

### **Communication and cooperation**

#### *Statutory requirements*

The FSB's power to cooperate and share information is provided in Section 22(3) of the FSB Act, according to which the Executive Officer or a Deputy Executive Officer may:

- Liaise with any regulatory authority on matters of common interest;
- Participate in the proceedings of any regulatory authority;
- Advise or receive advice from any regulatory authority;
- Prior to taking any material regulatory action against a financial institution, inform any regulatory authorities<sup>16</sup> having a material interest in that financial institution of the pending regulatory action, or where not possible, inform the relevant regulatory authorities as soon as possible after taking the regulatory action; and
- Negotiate and enter into bilateral or multilateral cooperation agreements, including MOUs, with regulatory authorities to, among other issues:
  - Coordinate and harmonize the reporting and other obligations of financial institutions and issuers;

<sup>14</sup> Such activities include for example dealing in OTC derivatives, see Principles 29-31 for further details.

<sup>15</sup> If a Strate participant is a bank, the responsibility for its prudential supervision lies with the SARB as per the Memorandum of Understanding between Strate and the SARB.

<sup>16</sup> A regulatory authority includes both South African and foreign statutory authorities responsible for the supervision or enforcement of legislation, a market infrastructure responsible for the supervision of persons it has authorized under the FMA, and an Ombud or a recognized Scheme (see Principle 31).

- Provide mechanisms for the exchange of information;
- Provide procedures for the coordination of supervisory activities to facilitate the monitoring of financial institutions or issuers on an ongoing basis; and
- Assist any domestic regulatory authority in regulating and enforcing any laws of that regulatory authority that are similar to the FSB legislation.

Section 6(3)(o) of the FMA includes a specific obligation on the Registrar of Securities Services to make adequate arrangements for effective cooperation with the Governor of the SARB in respect of monitoring and mitigating systemic risk.

*Cooperation in practice*

The FSB has signed an MOU with the SARB and the Financial Intelligence Centre (FIC) of South Africa for exchanging information and streamlining supervision and enforcement.

In the FSB-SARB MOU, the parties agree that there will be regular liaison at officer and senior executive level on operational and policy matters of mutual interest, in particular concerning financial conglomerates. Such liaison includes supervisory processes, audit/inspection strategies, analysis of relevant statistical information, market intelligence on the financial condition of the financial conglomerate members, participation in training programs, and other matters concerning general regulatory and supervisory issues or participation in forums where common issues are addressed. The MOU also includes specific guidelines on the supervision of financial conglomerates. To implement the cooperation requirement of the FMA, the FSB and SARB have formed a Systemic Risk Committee (see Principle 6). The FSB and SARB also organize standing bilateral discussions at senior management level, where overlapping supervisory issues relating in particular to conglomerate supervision are shared. Sometimes they conduct joint on-site visits and share information on entities and issues of joint supervisory interest.

The FSB also participates in the FSCF and the Financial Stability Oversight Committee (FSOC) together with other authorities, market infrastructures and market participants (see Principle 6).

Since the FSB does not have any regulatory responsibilities vis-à-vis issuers, the need for cooperation between the FSB and CIPC is limited to enforcement in case of misleading disclosures (see Principles 12 and 16).

There is close cooperation between the FSB and the market infrastructures. Under Section 70 of the FMA, the Registrar or a person nominated by him/her may attend any meeting of the controlling body (Board) of a market infrastructure or a Board committee and may take part, but may not vote, in all the proceedings at such meeting. As such, the FSB is represented in all the important meetings of the JSE and Strate and meets with their representatives on a regular basis to discuss issues of

	mutual interest (see Principles 9 and 34).
Assessment	Partly Implemented
Comments	<p>The responsibilities, powers and authority of the FSB and the Registrar are set out in several Acts. The FSB Act, the Inspection Act and the Protection of Funds Act apply across all FSB functions. The sectoral Acts may assign somewhat different powers to their respective Registrars. Therefore, even though within a particular Act the responsibilities, powers and authority of the respective Registrar may be clearly delineated, the current structure has led to some differences of approach between various FSB divisions and departments that in practice execute the powers assigned to each Registrar.</p> <p>The fact that the responsibilities for the supervision of market intermediaries—exchange members and FSPs—have been divided between the FSB and JSE has a potential of leading to regulatory gaps. The reason for this is that the JSE carries the primary responsibility for the supervision of exchange members, but it is focused only on the business that is covered by the JSE Rules. Exchange members can however also provide other services that are not covered by these Rules. For these activities the members are to be licensed as FSPs. Under the JSE Rules, they may also provide the same services that are provided by FSPs under the FAIS Act, such as investment management. Care must be taken in approving the JSE Rules to ensure the two regulatory frameworks do not diverge, leading to an unlevel playing field. Also, there is a risk that differences in the understanding of their respective responsibilities by the JSE and FSB may lead to gaps or duplication in the supervision applied to JSE members' activities.</p> <p>The sectoral Acts provide certain exemptive powers to the Registrar. To promote transparency and to provide a tool for market participants and the public to verify the equality of treatment, it is important to implement the publication requirement of Section 21 of the FSB Act in a uniform manner across the Registrars.</p> <p>As a result of the current sectoral legislation and the division of responsibilities both within the FSB and between the FSB and the other authorities, substantially the same type of products are currently not subject to consistent regulatory requirements. As part of their current efforts to ensure fair treatment of financial services customers across various sectors, the FSB and the other authorities are encouraged to focus also on harmonizing the regulatory framework for the products themselves.</p>
<b>Principle 2.</b>	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p><b>Political independence and accountability</b></p> <p><i>Appointment and removal of FSB Board members and senior management</i></p>

The requirements for the constitution of the FSB Board are in Section 4 of the FSB Act. It provides the Minister of Finance with the discretion to appoint as many Board members as he/she deems necessary, with due regard to the interests of the users of financial services and the suppliers of financial services, including financial intermediaries, and the public interest. The Minister of Finance may appoint an alternate member for every Board member. He also appoints one Board member as the chairperson and another member as the deputy chairperson.

Section 5 of the FSB Act includes criteria that disqualify a person from being appointed as an FSB Board member or alternate member:

- He<sup>17</sup> is not a citizen of, and permanently resident in, South Africa;
- In the opinion of the Minister of Finance, he/she is actually engaged in the business of a financial institution or actually engaged in the rendering of a financial service, subject to the possibility of the Minister of Finance to disregard this requirement on the basis of consultation with the recognized association or organization of the relevant financial institution or financial service in which such person is actually engaged;
- He is an unrehabilitated insolvent;
- He/she has at any time been convicted (whether in South Africa or elsewhere) of theft, fraud, forgery or uttering a forged document, perjury, any offence under the Prevention of Corruption Act, 1958, the Corruption Act, 1992, certain provisions of Chapter 2 of the Prevention and Combating of Corrupt Activities Act, 2004, or any offence involving dishonesty, and has been sentenced to imprisonment without the option of a fine or to a fine exceeding ZAR 100; or
- He is of unsound mind.

The FSB Board Charter (which has not been formally approved by the Minister of Finance) limits the Minister's choice in appointing the Board chairperson and deputy chairperson to independent Board members. The Charter further notes that the Board must reflect an appropriate balance of power and authority to enable effective decision-making. The composition of the Board must reflect the appropriate demographics and mixture of skills. According to the Charter, the Board will implement continuous professional development programs to ensure that its members receive regular briefings on changes to risks, laws and the regulatory environment. Board members also serve in various Board Committees, including those that deal with regulatory, supervisory and enforcement decisions (see Principle 4).

The current FSB Board includes one SARB representative and one Ministry of Finance

<sup>17</sup> Section 5 does not consistently refer to two genders.

representative. The other members have varying backgrounds, but none of them appears to be currently directly engaged in the provision of financial services.

A member or alternate member of the Board must vacate his/her office, if he/she becomes subject to one of the above disqualifications or if he/she has been absent for more than two consecutive Board meetings without leave of the Chairman. In addition, the Minister of Finance may at any time terminate the membership of any Board member or alternate member, if in the opinion of the Minister of Finance sufficient reasons exist for it (Section 6 FSB Act). However, in his/her decisions the Minister is bound by the principle of legality included in the South African Constitution. According to the FSB, the decision to terminate a Board member's appointment is also subject to Section 3 of the Promotion of Administrative Justice Act 3 of 2000 (PAJA), which requires an administrative action that materially and adversely affects the rights or legitimate expectation of any person to be materially fair.

The term of a Board member and alternate member is determined by the Minister of Finance at the time of appointment, and cannot exceed three years. However, the term of office of not more than 50 percent of the members or alternate members can expire within any calendar year. If a Board member or alternate member vacates his/her office, another person may be appointed to act in the place of such member or alternate member for the unexpired period of the term of office. Any person whose term of office has expired is eligible for reappointment. There are currently no limitations on the number of terms that a Board member can serve, and some FSB Board members have served in their position since the 1990s.

The Minister of Finance also appoints the members of the FSB Appeal Board established under Section 26A of the FSB Act (see below for the responsibilities of the Appeal Board). Office bearers of any political party, members of Parliament or provincial legislature, or municipal councillors cannot be appointed to the Appeal Board. A member of the Appeal Board is appointed for a maximum period of three years, and may be reappointed. The Minister of Finance appoints the chairperson and deputy chairperson from the members of the Appeal Board. There are currently 12 members in the Appeal Board, including five attorneys, two advocates and four members that are active in the accounting field. The chair of the Appeal Board is a retired judge. The Minister of Finance must remove an Appeal Board member from office, if he/she no longer meets the criteria stipulated in Section 26A(3) of the FSB Act.<sup>18</sup> The Minister of Finance may also, after affording the member a reasonable opportunity to be heard, terminate his/her period of office for unsatisfactory performance or inability to perform the functions of the office effectively. If the performance of the Appeal Board is unsatisfactory, the Minister of Finance may

<sup>18</sup> These criteria are similar to those applied to a Board member and alternate member.

terminate the period of office of all the members of the Appeal Board.

The Minister of Finance determines the remuneration and allowances to be paid to a member and an alternate member of the Board, Appeal Board and any Board Committee, if they are not in the full-time employment of the State.

Under Section 9 of the FSB Act, the FSB is required to have an Executive,<sup>19</sup> which must perform the functions of the FSB between Board meetings, in accordance with the Board's policy and instructions. The Executive Committee consists of the Executive Officer, the Deputy Executive Officers, the Chief Actuary and such other officers or employees of the FSB as the FSB may from time to time appoint on such conditions as it deems fit. The Minister of Finance appoints the Executive Officer, the Deputy Executive Officers and the Chief Actuary, after consultation with the Board (Section 13(1)(a) FSB Act). At the moment the FSB Executive Committee consists of ten members, including the Executive Officer, five Deputy Executive Officers, the Chief Actuary, the Chief Financial Officer, the Chief Information Officer and the Chief Operations Officer (see the organization chart in Principle 1). Therefore, seven out of ten Executive Committee members have been appointed by the Minister of Finance. The Minister's power to remove the Executive Committee members is not specifically addressed in the FSB Act, but in practice the Minister would have the discretion to remove them as officials appointed by him/her. However, the above-mentioned principle of Section 3 of PAJA would also apply in this case.

The Minister of Finance appoints the chairperson, other members and alternate members of the DMA. A member and an alternate member hold office for a period not exceeding three years as the Minister may determine and is eligible for reappointment upon the expiry of his/her term of office. The Minister may remove the chairperson from his/her office or terminate the membership of any other member on good cause shown and after having given the member sufficient opportunity to show why he/she should not be removed or why his/her membership should not be terminated.

The Minister of Finance also appoints the DMA members as follows:

- The Executive Officer and/or his/her deputy;
- One person and an alternate from the JSE;
- One person of appropriate experience and an alternate from each of the following categories;
  - Accountant;
  - Insurance industry;

<sup>19</sup> The FSB refers to the Executive as the Executive Committee, which name is used in this report.

- Banking industry;
- Fund management industry;
- Any organization that represents shareholders' rights or any other similar organization chosen by the Minister of Finance;
- One person of appropriate experience and an alternate nominated by the SARB; and
- Two other persons of appropriate experience and their alternates.

According to the FSB, no DMA members are currently active market participants.

#### *Consultation of Minister of Finance*

According to Section 18(2) of the FSB Act, the FSB and its Executive Committee members must consult with the Minister of Finance on any matter relating to the exercise of such of their powers and the performance of such of their duties under the FSB Act or any other law as the Minister of Finance may determine. According to the FSB, the Minister of Finance has not issued any such determination any such matters, and such consultation does not therefore take place.

Section 71(4)(b)(i) requires the Registrar to inform the Minister of any amendment he/she has made to the rules of a market infrastructure, giving reasons for the amendment and explaining the urgent imperative under exceptional circumstances that required him/her to amend the rules. However, there is no requirement to consult the Minister before making such amendments.

#### *Minister's regulations*

The various sectoral Acts empower the Minister of Finance to make regulations. There are differences in the way this power is formulated and the extent to which the Registrar's views have to be heard in the process. The FAIS Act requires the Minister of Finance to consult the Registrar before making regulations, whereas Cisca and CRSA do not include a similar requirement. The FMA requires the Minister of Finance to consider any recommendations from the Registrar prior to the publication of draft regulations. Section 107(1) of the FMA includes a specific requirement that, in making regulations, the Minister of Finance must maintain the operational independence of the Registrar. The Minister of Finance must submit the draft regulations made under the FMA and the CRSA (but not under the FAIS Act and Cisca) to Parliament, while it is in session, for parliamentary scrutiny at least one month before promulgation. After promulgating the regulations, a copy of the promulgated regulations must be tabled in the Parliament.

#### *FSB measures*

The FSB has the power to make rules under Section 19 of the FSB Act, Section 26 of the FAIS Act and Section 24 of the CRSA. In addition, the Registrar may issue notices (Board Notices) in the Gazette and/or on the official website under some sectoral Acts

that can be of general application. Similarly, as of February 28, 2014 the Registrar may issue directives under all the sectoral Acts that can apply either generally or only to a specific person or service. The Registrar can also prescribe a range of other binding subordinate measures such as fit and proper requirements, codes of conduct, etc. When formulating these, the Registrar is not required to consult or seek the approval of the Minister of Finance or other government authority.

#### **Independence from commercial or other sectoral interests**

It appears that none of the FSB Board members currently work for a FSB regulated entity. A few appear to be engaged in investment activities. In addition, the Licensing Committee of the Board includes three industry representatives (see Principle 3). The Board is increasingly informed of the FSB's supervisory and enforcement activities, and the Licensing Committee is consulted in every FSB licensing decision.

#### **Political and public accountability**

The FSB Act includes a reference to the FSB annual report in Section 21. Even though this provision includes only an implicit requirement to prepare an annual report, in practice the FSB has always prepared one after the end of its financial year (March). The FSB Annual Report includes a description of its activities and its audited financial statements audited by the Auditor General (that in practice outsources the audit work to a professional audit firm). The FSB Annual Report is also submitted to the Parliament, and the FSB is expected to present it to the relevant portfolio committee of the Parliament. The Annual Report is also published on its website.

Some Registrars have a specific requirement to prepare an annual report (for each calendar year). In relation to the scope of the IOSCO Principles, this requirement applies only to the Registrar of Collective Investment Schemes. Section 23 of CISCA requires the Registrar to submit to the Minister of Finance an annual report concerning his/her activities in relation to CISCA, the activities of all managers and associations, and all matters relating to the administration of CIS and analogous schemes. This report must also be tabled in the Parliament within 14 days of its publication, if the Parliament is in session, or otherwise within 14 days of the commencement of its next session.

All FSB subordinate measures must be published either in the Gazette or on the official website (see Principle 4). In practice, the FSB always publishes such measures also on its website, even if the official requirement would be limited to publication in the Gazette. For the most part, the same legal obligation applies to the Minister's regulations (with the exception of the regulations issued under CISCA<sup>20</sup>). However, the structure of the FSB website, where the regulatory measures are published under the various divisions or departments following a non-harmonized structure makes

<sup>20</sup> At the moment there are no ministerial regulations issued under CISCA.

identifying the up-to-date, binding measures very challenging.

The FSB publishes most of its supervisory and enforcement actions. In some cases this is specifically required in the relevant legislation. For example, Section 14A of the FAIS Act refers to the right of the Registrar to publish a debarment of a person and the reasons for it, or the lifting of a debarment, by notice on the official website or by means of any other appropriate public media. Section 6G of the Protection of Funds Act requires the Registrar and the DMA to make public an EC determination in a manner they deem appropriate. However, there are no uniform requirements for the publication of supervisory and enforcement measures, and the practices of the Registrars are somewhat different in this regard.

### **Stability and continuity of funding**

According to Section 16 of the FSB Act, the funds of the FSB consist of service fees and levies imposed on financial institutions, money borrowed and money accruing from any other source. The FSB may impose by notice in the Gazette the levies on financial institutions (Section 15A FSB Act). Before imposing such levies, the Board must publish the proposed levies, together with a statement that representations about the proposed levies may be made within a specified time. Before imposing the final levies, the Board must have regard to any such representations. The FSB fees to be charged under the FAIS Act (but not other Acts) are determined by the Minister of Finance, after consultation with the Registrar, by notice in the Gazette (Section 41 FAIS Act).

In addition to fees and levies, the FSB may ask for an order from the appropriate adjudicatory body to be compensated for the costs of an investigation on a regulatory breach (see Principle 11). If violators are ordered to return any profits from a violation or ordered to pay a monetary penalty, the FSB places these funds into a segregated account to compensate victims and to pay for its investor education programs.

The FSB's annual budgetary process aims at reaching a zero balance at the end of the financial year. When surplus funds are collected, the FSB explores ways to refund excess levies in the form of rebates to the specific industries.

### **Bona fide legal protection**

Legal protection to the FSB and its staff is provided in Section 23 of the FSB Act, according to which no person will be liable for any loss sustained by or damage caused to any other person as a result of anything done or omitted by that person in the bona fide exercise of any power or the carrying out of any duty or the performance of any function under the FSB Act, the relevant sectoral Acts, the Inspection Act or the Protection of Funds Act. The Act does not provide that the FSB will indemnify these persons for the costs of defending themselves against suits. However, the FSB has an insurance policy to cover its and its management's and employees' legal costs in case of a suit.

In practice, several actions for civil damages have been instituted against the FSB (see e.g., the FSB 2012/2013 Annual Report).

### **Accountability for decisions**

The South African Constitution and PAJA require that all administrative decisions affecting the rights of persons must be lawful, reasonable and procedurally fair. PAJA gives effect to this constitutional principle of administrative justice and ensures the legality of all administrative action. The FMA (Section 6(3)(f)) includes a specific requirement for the Registrar to act in accordance with PAJA. Despite the lack of specific references in the other Acts, all actions taken by the FSB and Registrars are subject to PAJA, since they are covered by the definition of administrator in PAJA.

In addition, the Protection of Funds Act includes detailed requirements on the procedures to be applied in referrals to the EC and in the EC proceedings. Similarly, the FSB Act sets the process to be followed in the Appeal Board proceedings.

The sectoral Acts include various procedural requirements applicable to the FSB decisions, including on whether reasons need to be provided. Examples of such requirements include:

- Section 9(2)(a)(ii) of the FAIS Act requires that, before suspending or withdrawing any license, the Registrar must inform the licensee of the intention to suspend or withdraw the license and the grounds for it and must give the licensee a reasonable opportunity to make a submission in response thereto;
- Section 60(2) of the FMA requires that the Registrar, before cancelling or suspending a license, informs the market infrastructure of the Registrar's intention to cancel or suspend, gives the market infrastructure the reasons for the intended cancellation or suspension, and calls upon the market infrastructure to show cause within a period specified by the Registrar why its license should not be cancelled or suspended;
- Section 16(2) of Cisca requires that the Registrar may not cancel or suspend the registration of a manager, unless he/she has notified the manager of his/her intention and of the grounds upon which he/she proposes to do so, has allowed the manager to make representations, and afforded the manager a reasonable opportunity to rectify or eliminate the defect, irregularity or undesirable practice; and
- Section 18(2) of Cisca requires that the Registrar must, before imposing a fine, by written notice to the manager or third party inform it of his/her intention to impose a fine, specify the particulars of the alleged failure, set out the reasons for the intended imposition of a fine, specify the amount of the fine intended to be imposed, and call upon the manager or third party to show cause within a period specified by the Registrar why the fine should not

	<p>be imposed.</p> <p>Under Section 6D(4)(a) of the Protection of Funds Act, a determination of an EC panel must be in writing and state the reasons for the determination.</p> <p>Section 3 of PAJA contains general procedural fairness requirements. It requires that administrative action which materially and adversely affects the rights or legitimate expectations of any person must be procedurally fair. An administrator must give an affected person:</p> <ul style="list-style-type: none"> <li>• Adequate notice of the nature and purpose of the proposed administrative action;</li> <li>• A reasonable opportunity to make representations;</li> <li>• A clear statement of the administrative action;</li> <li>• Adequate notice of any right of review or internal appeal, where applicable; and</li> <li>• Adequate notice of the right to request reasons.</li> </ul> <p>Under PAJA there is therefore no specific requirement to include reasons in the original decision, but they can be requested and provided afterwards. More specifically, Section 5 of PAJA provides that any person whose rights have been materially and adversely affected by administrative action and who has not been given reasons for the action may, within 90 days after the date on which that person became aware of the action or might reasonably have been expected to have become aware of the action, request that the administrator concerned furnish written reasons for the action. The administrator must, within 90 days after receiving the request, give the requesting person adequate reasons in writing for the administrative action. An administrator may depart from the requirement to furnish adequate reasons, if it is reasonable and justifiable in the circumstances, and must forthwith inform the person making the request of such departure.</p> <p>In order to promote an efficient administration, the Minister (the Cabinet member responsible for the administration of justice) may, at the request of an administrator, by notice in the Gazette publish a list specifying any administrative action or a group or class of administrative actions in respect of which the administrator concerned will automatically furnish reasons to a person whose rights are adversely affected by such actions, without such person having to request reasons. The Minister must, within 14 days after the receipt of such request and at the cost of the relevant administrator, publish such list. This process has not been applied to FSB actions. As noted, the requirement to provide reasons is already included in many legal provisions applicable to the FSB's administrative actions. In practice, the FSB gives reasons for all substantive decisions where a person's rights are affected, such as licensing decisions.</p>
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*Appeal to the FSB Appeal Board*

According to Section 26 of the FSB Act, a person who is aggrieved by a decision of a decision maker (as defined in the relevant Acts) may appeal that decision to the FSB Appeal Board established under Section 26A of the FSB Act. An appeal must be lodged within 30 days of the person becoming aware of, or ought to have become aware of a decision, in the manner and on payment of the fees prescribed by the Minister of Finance. An appeal does not suspend any decision pending the outcome of the appeal, unless the chairperson or a deputy chairperson of the Appeal Board, on application by a party, directs otherwise.

The chairperson or deputy chairperson of the Appeal Board must assign each appeal to a panel consisting of at least three suitably qualified Appeal Board members. The chairperson of a panel hearing must be an advocate, attorney or judge. Any party to an appeal may be represented by a legal representative. An appeal is decided on the written evidence, factual information and documentation submitted to the decision maker before the decision was taken. Unless the chairperson grants an exemption, no oral or written evidence, factual information or documentation other than what was made available to the decision maker, may be submitted to the panel by a party to the appeal. If further evidence, information or documentation is allowed, the matter must revert to the decision maker for reconsideration and the appeal is deferred pending the final decision of the decision maker. The decision of the majority of the panel members is the decision of the Appeal Board. The decision must be in writing and a copy must be furnished to every party to the appeal within a reasonable period. The Appeal Board may confirm, set aside or vary the decision under appeal, and order that the Appeal Board decision be given effect to, or remit the matter for reconsideration by the decision maker. An Appeal Board order has legal force and may be enforced as if it were issued in civil proceedings in a division of the High Court within whose area of jurisdiction the Appeal Board held its sitting. The decision of the Appeal Board must be made public.

The Appeal Board's power extends beyond the decisions of the FSB and the Registrar. Under Section 105 of the FMA, the Appeal Board also hears appeals on the decisions of an exchange, CSD and independent clearing house authorized under the FMA. Similarly, it also hears appeals on the decisions of the Ombud under Section 39 of the FAIS Act.

The appeal body for the EC decisions is the High Court (Section 6F Protection of Funds Act). The launching of such appeal proceedings does not suspend the operation or execution of a determination, unless the chairperson of the EC that dealt with the matter directs otherwise.

*Judicial review*

Section 7 of PAJA sets out the procedure for judicial review. A court or tribunal is not permitted to review an administrative action under PAJA unless any internal remedy

provided for in any other law has first been exhausted. The FSB Appeal Board process constitutes such an internal remedy. Any proceedings for judicial review must be instituted without unreasonable delay, and no later than 180 days after the date on which the appeal proceedings at the Appeal Board have been concluded.

Section 6 of PAJA provides that any person may institute proceedings in a court or tribunal for the judicial review of an administrative action. A court or tribunal has the power to review an administrative action if:

- The administrator who took it was not authorized to take the action or acted under a delegation of power which was not authorized by the empowering provision or was biased or reasonably suspected of bias;
- A mandatory and material procedure or condition prescribed by an empowering provision was not complied with;
- The action was procedurally unfair;
- The action was materially influenced by an error of law;
- The action was taken for a reason not authorized by the empowering provision, for an ulterior purpose or motive, because irrelevant considerations were taken into account or relevant considerations were not considered, because of the unauthorized or unwarranted dictates of another person or body, in bad faith, or arbitrarily or capriciously;
- The action itself contravenes a law or is not authorized by the empowering provision or is not rationally connected to the purpose for which it was taken, the purpose of the empowering provision, the information before the administrator, or the reasons given for it by the administrator;
- The action concerned consists of a failure to take a decision;
- The exercise of the power or the performance of the function authorized by the empowering provision, in pursuance of which the administrative action was purportedly taken, is so unreasonable that no reasonable person could have so exercised the power or performed the function; or
- The action is otherwise unconstitutional or unlawful.

Section 8 of PAJA provides the remedies in judicial review proceedings. The court or tribunal may grant any order that is just and equitable, including orders:

- Directing the administrator to give reasons or to act in the manner the court or tribunal requires;
- Prohibiting the administrator from acting in a particular manner;
- Setting aside the administrative action and:
  - Remitting the matter for reconsideration by the administrator, with or

without directions; or

- In exceptional cases substituting or varying the administrative action, correcting a defect resulting from the administrative action or directing the administrator or any other party to the proceedings to pay compensation;
- Declaring the rights of the parties in respect of any matter to which the administrative action relates;
- Granting a temporary interdict or other temporary relief; or
- As to costs.

#### *Market infrastructures*

Section 11(9) of the FMA requires an exchange, before refusing an application to include securities in the list, to inform the issuer of its intention to refuse the application, give the issuer the reasons for the intended refusal, and call upon the issuer to show cause within a period specified by the exchange why the application should not be refused. The same requirements apply when an exchange intends to remove from listing or suspend a security.

The market infrastructure rules also include certain procedural fairness requirements:

- According to Section 3.100 of the JSE Equities Rules, the JSE has the sole discretion to accept or reject an application for membership, or to accept it subject to certain conditions. The JSE must notify the applicant in writing of its decision and of any conditions that are required to be met. A person aggrieved by a JSE decision to reject a membership application may appeal to the FSB Appeal Board. Similar provisions are in the JSE Interest Rate and Currency (IRC) and Derivatives Rules;
- According to Section 3.7 of Strate Rules, the controlling body may, after examining an applicant's compliance with the participation criteria and the information submitted in accordance with the Strate Rules and Directives, decide, after consultation with the applicant, either to admit the participant or to reject the application. Where the controlling body has determined that an application should be rejected, it must, within a reasonable time, provide notice of its intended decision, together with the reasons for that decision, to the applicant. The applicant then has the right, within five business days, to state its case, in either written or oral form, to the controlling body as to why its application should not be rejected. After considering any representations made, or in the absence of any representations being submitted within the prescribed period, the controlling body must make its final decision on the matter. The possibility to appeal to the FSB Appeal Board applies also in this case.

There are also structures and processes built into the JSE and Strate rules that follow

	the requirements of procedural fairness when dealing with disciplinary matters.
Assessment	Partly Implemented
Comments	<p>The Minister of Finance has the power to appoint and remove the members of the FSB Board, the Appeal Board, the DMA, and the majority of the FSB Executive Committee. Very few limitations are placed on that power. Even though the Board's direct involvement in day-to-day regulatory, supervisory and enforcement decisions at the Board level is officially limited to oversight, three Board Committees (see Principle 3) are consulted by the FSB on regulatory, licensing and enforcement decisions. Some of these Committees also include industry representatives. At a minimum, this may create the perception of undue political or industry influence in the FSB decision making processes. The DMA, that does not include any active market participants, is a suitable model.</p> <p>The upcoming twin peaks legislation should include clear procedures for the appointment of the head and members of the governing bodies of the conduct and prudential authorities, and most importantly, clear limitations on the reasons for their removal (Key Question 5 of the IOSCO Assessment Methodology). Consideration should also be given on the role industry representatives play in the governance of the authority.</p> <p>The FSB is financed through fees and levies from supervised entities. The fees charged under the FAIS Act are determined by the Minister of Finance. Since this is not the case for the other Acts, this may be viewed as undermining the FSB's independence with respect to the supervision of FSPs. It is recommended this requirement be removed.</p> <p>There is currently no uniform FSB wide policy on the publication of supervisory and enforcement measures. It is important that the FSB have such a policy, to ensure that market participants and the public receive sufficient, consistent information on the FSB actions that affect them.</p>
<b>Principle 3.</b>	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p><b>Powers</b></p> <p>The FSB's powers and authorities are sufficient to meet the responsibilities assigned to it under the various Acts referred to in Principle 1.</p> <p><b>Funding</b></p> <p>The FSB's budget over the past three financial years and its estimated budget development over the next four financial years are presented in the following table:</p> <p>The FSB's budget has grown on average by 11.4 percent/year between the financial years 2010/2011 and 2012/2013 and is projected to grow on average by further</p>

5.4 percent/year from the current financial year to the financial year 2016/2017.

The FSB Board has the final responsibility to approve the FSB's budget, including the departmental breakdown.

#### FSB Budget Development (ZAR Thousand)

	2010/ 2011 <sup>/1</sup>	2011/ 2012	2012/ 2013	2013/ 2014	2014/ 2015	2015/ 2016	2016/ 2017
Administration	137,197	166,449	178,870	194,061	200,578	212,566	224,766
Financial advisory and intermediary supervision <sup>/2</sup>	105,257	112,908	121,785	119,064	124,837	131,951	139,527
Insurance supervision	44,518	67,911	76,188	95,327	99,866	105,812	112,112
Pension fund supervision	88,826	93,915	106,843	107,306	112,515	118,508	125,508
CIS supervision	15,078	18,772	18,267	19,212	20,149	21,408	22,723
Market infrastructure supervision	8,371	20,685	10,554	11,394	11,960	12,693	13,477
DMA	8,452	14,235	10,482	13,906	14,572	15,457	16,397
CRA regulation	-	-	-	3,046	3,300	3,619	3,983
Hedge fund regulation	-	-	-	689	903	1,073	1,271
Total	407,699	494,875	522,989	564,005	588,680	623,415	659,764

Source: FSB.

1/ The FSB's financial year runs from the beginning of April to the end of March of the following year.

2/ In addition to securities advisors and intermediaries, financial advisors and intermediaries supervised by the FSB include insurance advisors and intermediaries. It is not possible to break down the budget to these two categories.

#### Resources

The FSB had 511 full-time staff members at the end of the financial year 2012/2013. The staff turnover at the FSB level was 11.2 percent, significantly higher than the previous financial year's 6.0 percent. At the end of the financial year 2013/2014, the FSB level staff turnover was 12.0 percent.

The FSB has the authority to pay salaries comparable to private financial services industry pay scales. As a result, its staff is compensated at levels higher than the government norms. This has increased its ability to recruit and retain experienced staff, although the FSB's senior management expressed some concern about the FSB's ability to hire staff of sufficient expertise to meet the future challenges. The FSB has

been able to use some additional reward structures to enhance its compensation packages; for example, the top 20 percent exceptional performers and the Executive Committee members were awarded performance bonuses during the 2012/2013 financial year. However, the FSB has faced challenges in filling its open positions with staff with sufficient expertise in the FSB's particular areas of responsibility.

#### FSB Staff Composition and Turnover\*

Department	Total Number of Staff March 31, 2013	Staff Turnover (in percent) March 31, 2013	Total Number of Staff March 31, 2014	Staff Turnover (in percent) March 31, 2014
Capital Markets	10	30	9	0
Market Abuse	9	11	9	0
CRA	0	0	3	0
FAIS Supervision	57	21	64	19
FAIS Enforcement	6	33	9	22
FAIS Registration	30	10	28	21
FAIS Compliance	20	5	17	25
CIS	21	10	22	14

Source: FSB.

\*As relevant for the IOSCO assessment.

Some of the FSB's reporting systems do not support automation of monitoring compliance with the regulatory requirements (such as the quarterly portfolio reporting by CIS managers). Since the JSE has the main responsibility for market surveillance, the FSB does not have its own market surveillance capacity.

#### **Training**

During the financial year 2012/2013, the FSB spent ZAR 1.35 million on training and ZAR 520,000 on seminars and conferences. The training program covers a broad range of topics, ranging from specialized professional trading to soft skills training. In support of developing middle management talent, a custom-made program, entitled the FSB High Potential Program, run by the University of Stellenbosch, was developed and implemented for staff members deemed as having potential to operate at a higher level. A total of 28 employees finished the program during the 2012/2013 financial year.

#### **Governance**

##### *Board*

The FSB has a Board Charter approved by the Board, which sets out the Board's role and responsibilities as well as requirements for the Board composition and meeting procedures. According to the Charter, all Board members are non-Executive members. The FSB Executive Officer, Chief Operations Officer, Chief Financial Officer, Pension

Funds Adjudicator and the FAIS Ombud are standing invitees to all Board meetings. Other members of the Executive Committee of the FSB attend per invitation.

According to the Board Charter, the Board's role and responsibilities vis-à-vis the FSB include:

- Exercising leadership, while acting as the focal point for and custodian of corporate governance;
- Facilitating that strategies, risks, performance and sustainability are inseparable and give effect to this by:
  - Facilitating and approving the strategies;
  - Satisfying itself that the strategies and business plans of the FSB are not encumbered by risks that have not been thoroughly assessed by management;
  - Identifying key performance and risk areas;
  - Ensuring that the strategies will result in sustainable outcomes; and
  - Considering sustainability as a business opportunity that guides strategy formulation.
- Providing effective leadership that is based on an ethical foundation;
- Ensuring that the FSB is seen to be a responsible corporate citizen by having regard not only to the financial aspects of the business, but also to the impact those business operations have on the environment and the society within which it operates;
- Ensuring that the FSB's ethics are managed effectively;
- Ensuring that the FSB has an effective and independent Audit Committee;
- Being responsible for the governance of risk through the Risk Management Committee;
- Being responsible for information technology governance;
- Ensuring that the FSB complies with applicable laws and considers adherence to non-binding rules and standards of governance;
- Ensuring that there is an effective risk based internal audit;
- Acknowledging that stakeholders' perceptions affect the FSB's reputation;
- Ensuring the integrity of the FSB's financial reports;
- Reporting on the effectiveness of the FSB's system of internal controls; and
- Acting in the best interests of the FSB.

Section 5 of the Board Charter stipulates the matters that are reserved for decision by

the Board and that cannot be delegated. Examples of such matters are:

- Approving the FSB's policies, code of conduct, strategic plan, business plan and any material changes in strategic direction or material deviations in its business plan;
- Approving the delegation of authorities;
- Appointing Executive Committee members other than the ministerial appointments;
- Recommending to the Minister of Finance to take a particular course of action proposed by the FSB;
- Exercising oversight powers over the Executive Officer acting as Registrar;
- Making recommendations to the Minister of Finance regarding the appointment to and removal from the Board, including the appointment of the Chairperson and Deputy Chairperson; and
- Appointing the Chief Operations Officer, the Chief Financial Officer and the Chief Information Officer.

In practice the FSB Board meets quarterly, primarily to oversee the FSB's internal operations and governance. The Board is also regularly informed of supervisory and enforcement matters, but it does not make decisions on them.

According to Section 9(3) of the FSB Act, the FSB (i.e., the Board) may set aside or vary any decision of the Executive Committee, except a decision in consequence of which a payment has been made or any other right has been granted to any person. Since in practice the Executive Committee does not make any regulatory, supervisory or enforcement decisions, this provision does not appear to undermine the FSB's or the Registrar's independence.

#### *Board Committees*

According to Section 10(1) of the FSB Act, the FSB may establish committees to assist it in the performance of its functions and at any time dissolve or reconstitute such committees. Any person that complies with the conditions for the membership of the FSB Board may be appointed as a Committee member. The following Committees have been established: Audit Committee, Risk Management Committee, Human Resources Committee, Remuneration Committee, Licensing Committee, Litigation Committee and Legislative Committee. Under Section 10(3) of the FSB Act, the FSB is required to establish an Enforcement Committee to be responsible for enforcing compliance with the laws regulating financial institutions and the provision of financial services.

The first four of the above mentioned Committees are composed only of FSB Board members (2012/2013 Annual Report). The Licensing Committee, Litigation Committee and Legislative Committee also include non-Board members. The function of the

Licensing Committee (three Board members, five other members) is to ensure that the Registrar acts according to the legislation administered by the FSB (see Principles 24 and 29 for the role of the Licensing Committee in individual licensing decisions). Three of the Licensing Committee members work for FSB regulated entities. The Litigation Committee (three Board members, four other members) oversees the FSB litigation process for claims against or by the FSB. Finally, the Legislative Committee (four Board members, four other members) considers new legislation (including the various regulatory measures prepared by the FSB) or amendments to existing legislation relating to the FSB's supervisory functions.

#### *Executive management*

As noted above, the Executive Committee performs the functions of the FSB in accordance with the FSB's policy and instructions between the Board meetings. The Executive Officer, subject to supervision by the Board, performs the functions entrusted to him/her in the FSB Act or any other Act. A Deputy Executive Officer or the Chief Actuary performs the functions delegated to the Deputy Executive Officer or Chief Actuary under the FSB Act and is accountable to the Executive Officer for the performance of those functions. (Section 13(3) FSB Act).

The powers of the FSB or Registrar may be delegated to other persons, including any employee. Sub-delegation is also permitted. The Board, the Executive Officer and the Deputy Executive Officers are required to develop an appropriate system of delegation that maximizes administrative and operational efficiency and provides adequate checks and balances in the performance of their functions. (Section 20 FSB Act).

In practice the Executive Officer/Registrar has delegated many of the duties under the various Acts to the relevant Deputy Registrar/Deputy Executive Officer. Further delegations have been made within the divisions. Supervisory decisions are primarily taken by the relevant Deputy Registrars, while enforcement decisions are taken either by the Deputy Registrar or the Enforcement Committee. Prior to decision-making, licensing decisions are submitted for discussion and recommendation to the Licensing Committee. The FSB Executive Committee meets every two weeks to discuss FSB wide issues, but it does not make supervisory or enforcement decisions as a committee.

#### **Investor education**

One of the functions of the FSB under Section 3 of the FSB Act is to provide, promote or otherwise support financial education, awareness and confidence regarding financial products, institutions and services.

The FSB has established a cross-sectoral Consumer Education Unit to promote and implement programs and projects on financial issues, such as budgeting, savings, insurance, investments, retirement funds, dealing with financial services providers, consumer rights and responsibilities and consumer recourse mechanisms. Delivery channels for dissemination of financial information include workshops, radio and

	<p>television, printed media and exhibitions.</p> <p>The FSB is a member of the Advisory Board of the International Network on Financial Education (INFE), and co-chairs the INFE Expert Sub-group on National Strategies. The FSB also chairs the Technical Committee on Consumer Financial Education of the Committee of Insurance, Securities and Non-banking Financial Authorities.</p> <p>The FSB conducted a national survey on financial literacy levels in South Africa in 2011 and used its results to develop a National Strategy for Consumer Financial Education in South Africa in 2013. The strategy development process was guided by the National Treasury.</p> <p>Market infrastructures are required to report on their consumer education initiatives. Under Section 69 of the FMA, a market infrastructure must within four months after the financial year end submit an annual report containing the details prescribed by the Registrar. The information that must be contained in the annual report includes a status report on the market infrastructure's consumer education initiatives, if any (Board Notice 101).</p>
Assessment	Broadly Implemented
Comments	<p>The FSB and the Registrar have sufficient policies and governance practices to perform their functions and exercise their powers within the current legislative framework. However, the structures of the legislation and of the FSB have fostered a siloed approach to decision making. The FSB has tried to improve the coordination and cooperation between the various functions by, among other measures, organizing regular Executive Committee meetings. The conversion of the FSB to a conduct authority and the related legislative changes to its governance structure should assist the FSB in undertaking its responsibilities in an increasingly harmonized manner.</p> <p>Even though the level of the FSB's resources is generally considered to be sufficient, it has faced challenges in recruiting staff with sufficient expertise in the FSB's area of responsibilities. Staff turnover in certain departments has also been high. The transformation to the conduct authority and assumption of new tasks will further enhance the need to maintain current and attract new talent.</p>
<b>Principle 4.</b>	The regulator should adopt clear and consistent regulatory processes.
Description	<p><b>Policy development process</b></p> <p>At the moment the various regulation and rulemaking procedures of both the Minister of Finance and the FSB are addressed only at a general level in the different sectoral Acts.</p> <p>In the General Amendment Act, Section 18(3) was added to the FSB Act. It includes a requirement for the Minister of Finance to prescribe a code of norms and standards for consultation for the FSB Board and Registrars, which must:</p>

	<ul style="list-style-type: none"> <li>• Require that appropriate stakeholders to be consulted are identified; the purpose and scope of consultation are clear; the timing, medium and process of consultation are appropriate, proportional and transparent; consultation material is clear; and stakeholder input is considered and feedback provided; and</li> <li>• Stipulate requirements and standards relating to publication.</li> </ul> <p>The commencement date of the above provision has been delayed until the Minister's code has been prepared.<sup>21</sup> The intention is to publish the code, once it has been finalized.</p> <p><i>Development of Minister of Finance regulations</i></p> <p>Each sectoral Act has separate and different provisions on the regulation-making process. The provisions governing making of regulations by the Minister of Finance are as follows:</p> <ul style="list-style-type: none"> <li>• FAIS Act: Section 35 provides that the Minister of Finance may by notice in the Gazette, after consultation with the Registrar, make regulations on certain matters. There are no other process requirements in the FAIS Act;</li> <li>• Cisca: Section 114 refers to regulations by the Minister of Finance, but does not include any requirements on the process for developing such regulations;</li> <li>• FMA: Section 107(2) includes specific requirements about the process for developing regulations. Before the Minister of Finance makes any regulation, he/she must: <ul style="list-style-type: none"> <li>• Ensure consultation with recognized industry bodies;</li> <li>• Consider any recommendations from the Registrar prior to the publication of draft regulations;</li> <li>• Publish a notice of the release of draft regulations in the Gazette, indicating that the draft regulations are available on the National Treasury official website, and call for public comment in writing within a period (at least 30 days) stated in the notice;</li> <li>• In respect of draft regulations to be published under Section 5(1) of the FMA (such as extending regulation to unlisted securities or a new category of unregulated persons), publish on the National Treasury official website, along with the draft regulations, a policy document that informs the draft regulations, and a report on the expediency, effect and implication of the regulations;</li> </ul> </li> </ul>
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<sup>21</sup> Until February 28, 2014, the FAIS Act and Cisca provided for advisory bodies, consisting of industry representatives, that had to be consulted before the Minister or the Registrar prescribed regulations and other subordinate measures. The General Amendment Act removed the requirement to establish Advisory Committees.

	<ul style="list-style-type: none"> <li>• In respect of draft regulations extending regulation to a new category of unregulated persons, publish a notice identifying the persons who may be declared to be regulated persons and inviting comment from those persons in writing within a period (at least 30 days) stated in the notice;</li> <li>• Submit the draft regulations to the Parliament, while it is in session, for parliamentary scrutiny at least one month before their promulgation;</li> <li>• Table a copy of the promulgated regulations in the Parliament; and</li> <li>• Within a reasonable period after prescribing regulations, publish on the National Treasury official website a document summarizing the comments received, and provide a brief response to those comments that were not accommodated.</li> </ul> <ul style="list-style-type: none"> <li>• CRSA: Section 34 requires the Minister of Finance to publish a notice of the publication of the draft regulations in the Gazette, submit the draft regulations to the Parliament for parliamentary scrutiny and submit a copy of the regulations to the Parliament. However, the FMA requirements to consult the industry, consider the recommendations of the Registrar and publish a feedback statement do not apply.</li> </ul> <p><i>Development of FSB rules and other regulatory measures</i></p> <p>According to Section 19 of the FSB Act, the FSB may make rules on any matter which it may deem necessary or expedient to prescribe or to regulate in order to achieve the objectives of the FSB Act. It further states that the FSB may make any such rules known in such manner as it may deem fit. There are no references to the FSB's power to issue other regulatory measures in the FSB Act. Instead, most of the requirements are included in the sectoral Acts.</p> <p>The procedural requirements for the development of FSB rules and other regulatory measures are not uniform, given the number of different Acts and the range of measures that the FSB can use. The legislation does not include any formal requirement for the FSB or the Registrar to consult market participants or the public before they take any of their own regulatory measures. The following table highlights the legal requirements that focus on the publication of the final measures through different media<sup>22</sup> rather than the consultative process as such:</p>
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<sup>22</sup> The Interpretation Act 33 of 1957 provides that subordinate legislation must be published in the Gazette unless another method is prescribed in the legislation in question.

### Procedural Requirements for FSB Regulatory Measures

	FAIS Act	CISCA	FMA	CRSA
Rules	Section 26(2)(b): publication in the Gazette.	Section 52: No procedural requirements.	No reference to FSB rule making power.	Same requirements as for the Minister's regulations.
Directives of general application	Section 38C(5): publication on the official web site and in any other appropriate media.	Section 15B(5): publication on the official web site and in any other appropriate media.	Section 6(5): publication in the Gazette and on the official website, tabling of a published copy in the Parliament.	Section 26(5): publication in the Gazette and in any other appropriate media, tabling of a published copy in the Parliament.
Various other measures, such as codes of conduct, determinations, declarations, fitness and propriety requirements	Notice on the official web site, unless notice in the Gazette is specifically required.			

Source: FAIS Act, CISCA, FMA, and CRSC.

In practice, the various Registrars publish draft regulatory measures for comment accompanied by explanatory memoranda. After the end of the consultation, some Registrars issue explanatory response documents (including comments matrices) and public statements. The Board's Legislative Committee reviews the measures before their finalization.

In addition to the above binding measures, the Registrar of Securities Services is specifically empowered to issue guidelines on the application and interpretation of the FMA (Section 6(3)(k) FMA). The other sectoral Acts do not include a similar power, but in practice the other Registrars issue circulars and guidance notes on the interpretation of some provisions when needed.

The FSB has included links to or copies of the relevant Acts, Minister's regulations and FSB regulatory measures on its website. Some (in particular the Acts) are available only through a subscription based service. In addition, in order to locate the relevant documents, it is necessary to know which department is responsible for a particular Act and where, under that part of the website, the materials have been posted. The divisions do not follow a consistent structure in presenting information on the website.

*Development of self-regulation*

According to Section 11(6) of the FMA, an exchange must have a consultation process for amending its listing requirements and that process must be set out in the Listing Requirements. The process must provide for the persons to be consulted and the manner of consultation, including the time period or periods allowed for consultation. An exchange must submit the proposed amendment, an explanation of the reasons for the amendment, and any concerns or objections raised during the consultation process to the Registrar for approval. The Registrar must as soon as possible publish the amendment on the official website and a notice in the Gazette, calling upon all interested persons to lodge any objections with the Registrar within a period of 14 days. When the Registrar has decided to approve or amend the proposed amendment, it must publish on the official website the amendment and the date on which it comes into operation and in the Gazette a notice that the amended listing requirements are available on the official website and the exchange website.

The above requirements have been implemented through Sections 1.30-1.31 of the JSE Listing Requirements (Equities) and Debt Listing Requirements. Both require a public consultation process to amend the JSE Listing Requirements. The proposed amendments to the Listing Requirements are published through the Stock Exchange News Service (SENS) inviting comments from affected parties for a period of one month. Once the public consultation process has been completed, the JSE submits the proposed amendments, an explanation of the reasons for them and any concerns or objections raised during the public consultation process to the Registrar for approval.

Section 71 of the FMA contains similar provisions relating to the amendment of the rules of a market infrastructure. With regards to the required consultation process, for example the JSE Equities Rules (Section 2.60) provide that any member of the JSE Executive may propose in writing any amendment of the rules or directives. The JSE Executive will consider the proposed amendment and notify members by JSE Gazette of its decision. If, within ten days of the announcement of the JSE Executive's decision to adopt the proposal, five or more members object in writing the decision, the objection, together with the reasons submitted by the relevant members, will be referred to the JSE Board for determination. If an objection to a proposed rule amendment has not been lodged within the prescribed period, or the JSE Board upholds the JSE Executive's decision to adopt the proposal, the amendment must be submitted to the Registrar for his/her approval. If an objection to a proposed directive amendment has not been lodged within the prescribed period, or the JSE Board upholds the JSE Executive's decision to adopt the proposal, the amendment will take effect immediately. Similar process is set out in Sections 2.6-2.19 of Strate Rules.

**Procedural fairness**

The procedural fairness requirements are described in Principle 3.

**Licensing decisions**

The criteria for authorizing FSPs and suspending or withdrawing their authorization are in Section 6A (fit and proper requirements) and Chapter II of the FAIS Act (see Principle 29). The criteria for the registration of managers of CIS in securities are set out in Section 42 of CISCA (see Principle 24 for other CIS types). The criteria for the cancellation or suspension of a manager's registration are in Section 16 of CISCA. The requirements for the authorization of applicants for exchange license are in Section 8 of the FMA (see Principle 33), and those for the applicants for a CSD license, clearing house license and trade repository license are in Sections 28, 48 and 55 of the FMA, respectively. The cancellation or suspension of the license of these market infrastructures is covered in Section 60 of the FMA. Finally, Sections 5 and 6 of the CRSA include the requirements for the registration as a registered CRA and suspension and cancellation of such registration (see Principle 22). These criteria are complemented by requirements that are publicly available in FSB Board Notices, fit and proper requirements, etc. The procedural requirements for the authorization/registration process, including the possibility to appeal a decision, are described in Principle 2.

The authorization requirements for exchange members are required to be included in the exchange rules (Section 17(2)(a) FMA). The same requirement applies to the rules of a CSD (Section 35(2)(b) FMA) and clearing house (Section 53(2)(b) FMA) in relation to their participants and clearing members. The procedural fairness requirements applicable to these market infrastructures are described in Principle 9.

**Confidentiality**

Section 22 of the FSB Act includes the requirements on the use and disclosure of information and co-operation. They provide that no information obtained in the performance of any relevant power or function may be used or disclosed to any person except:

- In the course of performing functions under, or as enabled by the relevant Acts;
- For the purposes of legal proceedings or other proceedings;
- When required to do so by a court; or
- By the Executive Officer or Deputy Executive Officer, if in their opinion disclosure is appropriate:
  - For purposes of warning the public against conducting business with a financial institution or other person conducting activities in contravention of the FSB legislation;
  - For purposes of informing the public of actions taken against a financial institution under the FSB legislation;

	<ul style="list-style-type: none"> <li>• For purposes of alerting the public to activities carried out by one or more financial institutions which the Executive Officer or Deputy Executive Officer believes to constitute a potential risk to consumers and in respect of which consumers should take care; or</li> <li>• In the public interest.</li> </ul> <p>Section 8 of the Inspection Act requires a person carrying out an inspection to preserve and aid in preserving secrecy with regards to all matters that come to his/her knowledge while conducting the inspection. An inspector may not communicate any such matter to any person except the Registrar, unless a court of law orders such communication or insofar as communication is necessary to properly carry out the inspection. The Registrar, however, may disclose any information obtained during an inspection, if he/she has reason to believe that an offence or irregularity has been committed relating to the affairs of the inspected institution or an inspected institution is in an unsound financial condition. The information may be disclosed to the following persons and entities, if they are affected by or have an interest in the information:</p> <ul style="list-style-type: none"> <li>• A department or organ of State;</li> <li>• A regulatory authority;</li> <li>• A self-regulating association or organization;</li> <li>• A statutory Board charged with supervisory or regulatory duties; and</li> <li>• A shareholder, partner, member, director, auditor, accounting officer, liquidator, curator, executor or trustee of the inspected institution.</li> </ul> <p><b>Consistency of the application of powers</b></p> <p>The FSB and the Registrars aim at ensuring the consistency of the application of their powers through various means. These include the issuance of guidance notes and circulars on the application of powers and authority and by providing all respondents an equal period to respond to a supervisory action. If licenses are suspended, the period of suspension is similar, with similar conditions for the lifting of suspension for similar contraventions.</p>
Assessment	Broadly Implemented
Comments	<p>Even though in practice the Minister of Finance and the FSB follow standard procedures in preparing the various legislative and regulatory measures, these procedures are currently not documented and disclosed to the public. The requirement for the Minister of Finance to prescribe a code of norms and standards for consultation in Section 18(3) of the FSB Act is an important development in this regard. In the upcoming legislative changes, it would be important to harmonize the legal requirements for consultation with the public across the sectors to ensure a</p>

	<p>uniform process and provide legal backing to the current practices.</p> <p>The authorities are also encouraged to expressly consider the cost of compliance with regulation in all sectors by preparing an impact assessment, cost-benefit analysis or equivalent when enacting new requirements or making substantive changes to existing ones. They should also ensure that all legislation and regulatory measures are easily available to the public. In this regard, it would be important to improve the public access to all of these measures by posting copies on the FSB website in an easily identifiable location and removing the need to subscribe to a commercial service.</p>
<b>Principle 5.</b>	The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.
Description	<p><b>Code of conduct</b></p> <p><i>Avoidance of conflicts of interest</i></p> <p>All FSB staff (including Executive Committee members) are subject to a Code of Conduct (Staff Code of Conduct) as part of their employment conditions. The Code provides that no employee is permitted to have any direct or indirect interest in any entity regulated by the FSB. The standard contract of employment requires an employee to declare any other business interest before commencing work. Employees must take all reasonable steps to ensure that no personal conflict of interest exists or may arise in connection with any agreed service or task that they are performing. Employees must consult their Head of Department for clarity, if there is any uncertainty or doubt whether a particular service or task poses a risk of conflict of interest, before commencing with such performance or task.</p> <p>Employees are required to disclose, annually and in writing, detailed particulars of their other outside business interests and the business interests or employment of their spouse or life partner in or by any institution regulated by the FSB or providing a service to the FSB. The FSB Executive Committee has reserved the right to instruct an employee to cease any activities, should the activity pose a risk of conflict of interest or impact on their work performance.</p> <p><i>Restrictions on holding and trading in securities</i></p> <p>The standard contract of employment with the FSB (under the heading investment in shares) prohibits an employee from having any direct interest in any entity regulated by the FSB. This prohibits holding securities of regulated entities. Further, the Staff Code of Conduct provides that an employee may not deal in any security without the prior approval in writing of his/her Head of Department, Deputy Executive Officer or Executive Officer (depending on who the employee reports to). According to the Staff Code of Conduct, such approval must not be granted for any security of an entity regulated by the FSB, if there is a real or perceived possibility of it creating a conflict of interest for the employee in the execution of his/her duties, presently or in the</p>

	<p>future, and there is a real or perceived possibility of the employee acting in contravention of the market abuse prohibitions in the FMA. Securities encompass shares, options, derivatives, single stock futures, contracts for difference and bonds.</p> <p><i>Confidentiality, secrecy and protection of personal data</i></p> <p>As noted above, Section 22 of the FSB Act includes requirements on the use and disclosure of information. All of the following persons must not use or disclose information obtained in the course of their duties with the FSB, other than in the situations described in Principle 4:</p> <ul style="list-style-type: none"> <li>• A member or former member of the FSB Board, a Board Committee, the Appeal Board or the EC (or any alternate member or former alternate member); and</li> <li>• The Executive Officer, the Deputy Executive Officers, the Chief Actuary, persons appointed by the FSB, officers and employees (including any employee, contractor, consultant or person acting on behalf of the FSB), while appointed or after such appointment has terminated.</li> </ul> <p>Section 8 of the Inspection Act includes confidentiality provisions for the persons carrying out the inspections (see Principle 4).</p> <p><b>Enforcement of the code of conduct</b></p> <p>Disciplinary proceedings may be instituted against any employee who contravenes the FSB Staff Code of Conduct. Possible sanctions are a warning, suspension without pay, final written warning, demotion or dismissal. Contravention of the confidentiality provisions in both the Inspection Act and the FSB Act constitutes a criminal offence. With regard to a contravention of the Inspection Act, the penalty may be a fine or imprisonment for a period not exceeding two years. The penalty for contravening Section 22 of the FSB Act is a fine not exceeding ZAR 1 million or imprisonment for a period not exceeding five years or both such fine and such imprisonment.</p> <p>The responsibility for enforcing staff discipline lies with the line managers. The FSB has policies in place to deal with staff discipline cases as and when such arise. Depending on the nature of the case, either an internal or external expert is contracted or assigned to work on a particular disciplinary case. Depending on the nature of the case, the staff member is either given a warning letter or, where misconduct is gross, he/she may be dismissed after a hearing has taken place. For example, nine employees have been subject to formal disciplinary action since January 2013, ranging from written warnings to termination of employment. One separation agreement was caused by a conflict of interest.</p>
Assessment	Broadly Implemented
Comments	The standard contract of employment with the FSB prohibits an employee from investing in the shares of a regulated entity. However, the Staff Code of Conduct

	<p>appears to enable the employee’s manager to grant an approval for dealing in the securities of a regulated entity under certain, not very strict conditions.<sup>23</sup></p> <p>The FSB should align or merge the requirements in the contract of employment and Staff Code of Conduct and ensure that the holding and trading prohibition applies to all securities, not only shares. At the same time, it is important to ensure that appropriate restrictions apply to all persons that may have access to confidential supervisory information, such as the FSB Board, Board Committee and DMA members. The FSB should also consider introducing an appropriate process to ensure that confidential information relating to entities other than those directly regulated by the FSB cannot be used for trading purposes. Such information can relate to, for example, confidential information received on listed companies in connection with an investigation or enforcement case.</p>
<b>Principle 6.</b>	<p>The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.</p>
	<p>The objectives of the FMA include contributing to the maintenance of a stable financial market environment and reducing systemic risk (Section 2). The FMA also includes a specific obligation for the Registrar to inform the Minister of Finance and the Governor of the SARB of any matter that in his/her opinion may pose systemic risk to the financial markets and to make adequate arrangements for effective cooperation with the Governor in respect of the monitoring and mitigation of systemic risk (Sections 6(3)(n) and (o)). Other Acts do not include specific references to monitoring and mitigating systemic risk. To give effect to the above cooperation requirement, the FSB and SARB have formed a Systemic Risk Committee that is in the process of initiating its activities. These include the compilation of a systemic risk register. Responsibility for this on the FSB side lies in the Capital Markets Department. The staff of this department also attend Strate’s Participant Failure Committee due to the potential systemic implications of a failure of a CSD participant.</p> <p>The FSB is a member of the FSCF, which is a financial industry wide contingency planning and crisis management forum chaired by a Deputy Governor of the SARB. The primary objectives of the FSCF are to identify potential threats of a systemic nature that may adversely impact the stability of the South African financial sector, to develop and coordinate appropriate plans, mechanisms and structures to mitigate these threats, and to manage systemic crises. The member organizations include the SARB, FSB, National Treasury, Banking Association of South Africa (BASA), South African Insurance Association (SAIA), JSE, Payments Association of South Africa</p>

<sup>23</sup> The weakness in the conditions arises from the wording of the provision in the Code. Permission may not be granted, if there is a possibility of a conflict of interest and the employee may be acting in contravention of the FMA market abuse provisions.

	<p>(PASA), South African Bankers Services Co Limited (Bankserv), Strate and ASISA.</p> <p>There is an MOU and related terms of reference, where the FSCF member organizations commit to share information required to assess systemic risk, report incidents with systemic risk potential, participate in crisis management processes and contribute to the mitigation of systemic risk. The main forum meets twice a year to discuss issues relevant to systemic risk. The FSB's participation in the FSCF meetings has not been regular in the past, whereas the SARB, the JSE and Strate regularly attend the meetings. Some securities markets related issues have been discussed in the meetings. The responsibility for the FSCF work is allocated to the Capital Markets Department, rather than having established an FSB level function to deal with systemic risks on a broader basis. The FSCF has an Operational Risk Sub-committee, whose objective is to identify and monitor operational risks in the financial sector that could potentially have a systemic impact, and to develop, test and maintain suitable crisis management and contingency plans to mitigate these risks.</p> <p>Finally, the FSOC has been informally established prior to the enactment of the twin peaks legislation. One of its purposes is to coordinate managing risk to financial stability. The FSOC is jointly chaired by the Governor of the SARB and the Minister of Finance.</p>
Assessment	Partly Implemented
Comments	<p>The first assessments of Principles 6 and 7 conducted by the IMF after the introduction of the new Assessment Methodology focused on three high level issues in assessing the existence of a process to identify systemic risk or to review the perimeter of regulation, which is required pursuant to Key Question 1 of the respective Principles: (i) whether the arrangements in place allow for a holistic (across products, entities, and markets) view of risk; (ii) whether they allow for a periodic reassessment of risk; and (iii) whether they allow for proper follow-up actions). The experience gained since has enabled an enhancement of the assessment criteria, for example, by looking at the type of data and analysis that the authorities use to identify such risks, and the degree to which the processes implemented allow for proper accountability. This is in line with the recommendations included in the recent report of the Assessment Committee of IOSCO.<sup>24</sup></p> <p>The need to monitor and mitigate systemic risk is taken into account in the FMA, whose scope of application is limited to market infrastructures, authorized users, central securities depository participants and clearing members. As result of this, most of the FSB level activities that aim at monitoring systemic risk are undertaken by the Capital Markets Department. There is a need for the FSB to develop organization wide</p>

<sup>24</sup> The enhanced assessment criteria have been applied since the assessments conducted from summer 2013 onwards.

	<p>arrangements for monitoring, mitigating and managing systemic risk possibly arising from securities markets in a more holistic manner.</p> <p>The processes in place through the FSCF, and those expected to be enhanced through the work of the FSOC, to some extent compensate for the lack of FSB level arrangements. However, the current arrangements are very high level, and the FSB does not appear to have been an active contributor to the discussions at the FSCF. As at the FSB, the focus of the FSCF securities markets discussions has been in the trading and post-trading matters. Limited analytical work of relevance to securities markets appears to have been conducted. It will be important to ensure that these cross-sectoral bodies will adopt and maintain a broad approach to analyzing potential sources of systemic risk, ensuring that those possibly arising from securities markets are sufficiently covered. The same applies to any dedicated macroprudential function to be established.</p>
<b>Principle 7.</b>	The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
Description	<p><b>Approach to reviewing the regulatory perimeter</b></p> <p>The FSB has a role in assisting the National Treasury in drafting the sectoral legislation in South Africa. There is also regular interaction between the FSB, SARB and National Treasury to consider legislative amendments. The FSB has a five year review cycle for all legislation falling under its responsibility. According to the FSB, the legislation is assessed against the IOSCO Principles, the FSAP findings and recommendations, the recommendations of the G-20 and the Financial Stability Board, as well as developments in comparable jurisdictions.</p> <p>The Capital Markets Department informed that it conducts regular reviews and benchmarking exercises based on various IOSCO reports to ensure that the legislative and regulatory framework is aligned with international best practice. The FMA allows the Minister of Finance to prescribe regulations. Further to this, the Registrar can issue additional regulatory measures and the market infrastructures can issue their own rules. Since the FMA is a new Act, the Registrar of Securities Services envisages conducting annual reviews and where necessary proposing legislative amendments.</p> <p>The FAIS Division has adopted a risk-based approach to the supervision of FSPs (see Principle 31). This approach enables the division to assess the risks posed by the products offered by the FSPs, monitor trends in the FSPs' activities and deal with the gaps identified. The FAIS Division informed that it also reviews the legislation for gaps and researches the market for risks. When such are identified, it aims at ensuring that the FAIS Act, subordinate legislation and the risk-based framework are updated to ensure consumer protection. Exemptions are granted for a specific period of time to allow for a reassessment of the appropriateness of the exemption after its expiry. In cases where exemptions are granted for an indefinite period, provision is made for</p>

their withdrawal at any time. Those exemptions are reviewed from time to time.

The CIS Division informed that it assesses the regulatory framework to identify and assess whether any amendments are required. The annual work plan includes reviews that are the result of the identification of the most pressing needs for review and change. The industry and ASISA play an important role in providing input in this regard. Further, the CIS Division assesses the FSB regulatory framework against the IOSCO benchmarks and makes changes where necessary.

#### **Recent measures to address the regulatory perimeter**

The FMA addressed previously identified gaps, for example by requiring the reporting of systemic risks, by addressing the SROs' conflicts of interest and by introducing codes of conduct for regulated persons. Another example where the authorities have extended the regulatory perimeter is the regulation of credit rating agencies (see Principle 22). Ongoing projects include the planned extension of the hedge fund regulatory framework to hedge funds themselves in addition to the current regulation of hedge fund managers (see Principle 28), the Treating Customers Fairly project, and the assessment of Bitcoin's risks to investors undertaken jointly by the National Treasury, the SARB and the Registrars of Financial Services Providers, Securities Services and Collective Investment Schemes.

Section 5(1) of the FMA provides a specific power for the Minister of Finance to prescribe requirements for the regulation of unlisted securities. The Minister of Finance may also extend regulation to currently unregulated persons, if it would in his/her opinion further the objects of the FMA. The ministerial regulations may then be complemented by various measures issued by the Registrar under Sections 6(7) and 6(8) of the FMA. The Minister of Finance and the FSB have used these provisions to propose extending the regulatory framework to OTC derivatives.

The Registrar of Securities Services has recently published for comment a draft regulatory framework for the regulation of public unlisted companies making a market in their own shares. These companies were not regulated in the past, but the growth in the activity to trade black economic empowerment shares has made it necessary to regulate this activity.

The Capital Markets Department has also conducted a gap analysis of the exchange's listing requirements against IOSCO reports on ETFs, ETNs, commodity derivatives, securitization and asset-backed securities. This resulted in a review of the current listing requirements. The Department has also conducted a gap analysis on the Codes of Conduct for Johannesburg Interbank Average Rate (JIBAR) and the South African Benchmark Overnight Rate (SABOR) in relation to the IOSCO Principles for Financial Benchmarks. This resulted in a review of the Codes of Conduct.

The FMA also now makes provision for the authorization of inter-dealer brokers as a category of authorized user. The exchange rules must now provide for the manner in which an authorized user acting as an inter-dealer broker is required to conduct its

	<p>inter-dealer broking services, including the manner in which it must broadcast bids and offers it receives, as well as for the circumstances in which an authorized user may or may not transact in listed securities using the services of an inter-dealer broker that is not an authorized user.</p> <p>The FAIS Division has indicated to the industry its intention to include private equity fund managers under the ambit of the FAIS Act in order to align the regulatory framework with international regulatory developments. In this regard, the Registrar has developed a draft Code of Conduct for Private Equity Fund Managers, which is currently under consultation with the industry.</p> <p>The Registrar of FSPs also recently discovered, as a result of a complaint, that some product issuers have structured the sign-on bonuses to intermediaries in such a way that they avoided the restrictions on incentives under the FAIS Act. The Registrar has therefore decided to amend the FAIS General Code of Conduct to prohibit the payment of such bonuses. Further, as a result of the recent failures of property syndications, the Registrar is also currently investigating the appropriateness of extending the FAIS scope to them.</p>
Assessment	Broadly Implemented
Comments	<p>The comments section of Principle 6 describes the criteria applied also to the assessment of Principle 7, and the recent amendments made to the assessment criteria.</p> <p>The FSB's approach to assessing the regulatory perimeter is still largely sectoral, although there is an increasing number of projects undertaken jointly by the various Registrars and/or with the other authorities. Due to the current complex division of responsibilities between the various authorities (and the FSB Registrars), there is a need to further enhance this joint approach to ensure that no products, entities or activities of concern inadvertently fall outside the regulatory perimeter and that the regulatory approach across sectors is sufficiently aligned. This will also assist in ensuring that there is sufficient accountability for this process.</p>
<b>Principle 8.</b>	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.
Description	<p>The regulation of conflicts of interest and misalignment of incentives is done at the level of the regulated entity. The various statutes and subsidiary instruments administered by the FSB generally require regulated entities to have policies and procedures in place to identify, eliminate or mitigate, and monitor conflicts of interest. Disclosure to their clients, customers, users or the public is mandated in most situations where there is or might be a conflict of interest.</p> <p>There is no formal, overall process in place at the FSB that focuses proactively on potential conflicts of interest in the marketplace or where there might be a</p>

misalignment of incentives between issuers and regulated entities. New or changing conflicts may be identified as part of the processes described in Principle 7 or during the supervisory process. Regulatory responses to conflicts of interest issues that the FSB deems suitable have been introduced as the issues have been identified.

### **CISCA**

The only conflict of interest provision in CISCA is a high level requirement for the CIS manager to avoid conflicts between the interests of the manager and the interests of an investor. The Registrar of CIS considers conflicts of interest at the time of registration of a manager and requires a manager to have a conflict of interest policy in place. Further, the Registrar is finalizing regulations for publication that would require conflicts of interest to be disclosed in certain marketing material and subscription forms. In addition, the supervisory program for on-site visits at CIS managers may include an evaluation of potential and actual conflicts during the regular supervisory visits to CIS managers. If problems are found, the Registrar communicates with the manager and directs it to take steps to eliminate the conflict.

### **FAIS Act**

Conflicts of interest and misalignment of incentives are addressed by specific requirements and prohibitions in the General Code of Conduct for Authorized FSPs and Representatives, Board Notice 80/2003 (the General Code of Conduct) to which all FSPs must adhere. The provisions cover both prohibitions of certain kinds of incentives (section 3A), the avoidance of conflicts and their general management (sections 3(1)(b) and (c)). Clients are required to be informed of these matters in writing.

The General Code of Conduct was amended in 2010 to add section 3A after an investigation into the conflicts of interest raised by certain types of incentives. The Registrar concluded that the disclosure of such incentives was inadequate and that certain incentives should be prohibited. Section 3A prohibits giving and receiving certain incentives. For example, under section 3A(1)(b), an FSP may not offer incentives to its representatives for giving preference to:

- The quantity of business secured to the exclusion of the quality of the service rendered to clients;
- A specific product supplier, where a representative may recommend more than one product supplier to a client; or
- A specific product of a product supplier, where a representative may recommend more than one product of that product supplier to a client.

In some instances, an FSP may only be paid a fee, if the client specifically agrees in writing to the fee and if the client can stop the payment. Representatives may not receive a financial interest (that includes remuneration), if it is paid for giving preference to the quantity of business to the exclusion of the quality of the financial

services or for giving preference to a specific product supplier or its products.

FSPs are required to make full disclosure of any actual or potential conflict of interest before the conclusion of any transaction and on an on-going basis but not less than annually. FSPs are required to have a comprehensive conflict of interest management policy that is approved by their Boards and reviewed on an annual basis. In addition, the FSP's management of conflict of interest policy must, inter alia, include a list of all associates, the names of any third party in which the provider holds an ownership interest, etc. This policy must be published in an appropriate media and the FSP must ensure that it is easily accessible for public inspection.

In addition, the compliance officer must monitor the FSP's compliance with the conflict of interest provisions and its conflict of interest management policy and must submit a report to the FSB on an annual basis on the implementation, monitoring and compliance with, and the accessibility of such policy.

Since the introduction of the Code requirements in 2010, the Registrar of FAIS has received several complaints regarding non-compliance with the conflict of interest provisions. These complaints were investigated and some culminated in enforcement action being taken against FSPs. In addition, the FSB established a task team to investigate specific practices in industry that are designed to circumvent the conflict of interest provisions.

#### **JSE Rules**

Under the JSE Equities Rules, in its dealings with clients, a member must avoid conflicts of interest and when they cannot be avoided, ensure fair treatment of clients by disclosure, confidentiality or declining to act. A member must not unfairly place its interests above those of its clients (section 8.10.2.5).

#### **FMA**

Under, section 62 of the FMA, a market infrastructure must take the necessary steps to avoid, eliminate, disclose and otherwise manage possible conflicts of interest between its regulatory functions and its commercial services. These steps must include:

- Implement appropriate arrangements that comply with the requirements prescribed by the Registrar;
- Document and make publicly available these arrangements; and
- Conduct an annual assessment, in the manner prescribed by the Registrar, of the arrangements and publish the results.

The market infrastructure must report annually on its compliance with this section.

The JSE, as an exchange licensed under the FMA, has certain self-regulatory responsibilities. It is accountable to the Registrar for ensuring that the objectives of the FMA are met in its self-regulatory role. In order to discharge the duty of regulation, the JSE is required to supervise the compliance of both issuers and

	<p>authorized users (exchange members) as well as enforce the rules governing them.</p> <p>In 2006, the JSE demutualized and proposed to list its own shares on the exchange. This raised a number of conflict issues. After consideration, it was decided that to prevent any conflicts of interest, the supervision of the JSE in terms of the JSE Listing Requirements would be transferred to the FSB. To address general concerns on the management of conflicts of interest, a new JSE Board Committee, the SRO Oversight Committee was created. It serves as an independent check on the appropriateness of the JSE's self-regulatory activities and the manner in which conflicts of interest are managed by the JSE. See the discussion in Principle 9. Governance structures and Chinese Walls have also been put in place to mitigate possible conflicts of interest at Strate.</p> <p>Under section 74(1) of the FMA, the Registrar may prescribe a code of conduct for authorized users, participants and clearing members. Draft Codes of Conduct have been prepared for authorized users and participants, who are required to disclose to the client the existence of any personal interest in the relevant service, or any circumstance which gives rise to an actual or potential conflict of interest in relation to such service as well as to take all reasonable steps to ensure fair treatment of the client.</p> <p>Further, the firm must take reasonable steps to ensure that it and any person acting on its behalf does not offer, give, solicit or accept any incentive, remuneration, consideration, fee or brokerage as an inducement, if it is likely to conflict with any duty that the authorized user owes to its clients in respect of securities services provided to those clients or any duty that the recipient of the inducement owes to its clients.</p> <p>These codes will be published for public comment.</p> <p>The FSB has no role in issuer disclosure, beyond approving the JSE Listing Requirements.</p> <p>See also the discussion of the regulation of conflicts of interest set out in Principles 9, 22, 23, 24, 28, 29, and 31.</p>
Assessment	Broadly Implemented
Comments	<p>There is no formal FSB-wide process in place focusing on conflicts of interest and misalignment of incentives. However, when issues of concern are identified, they are addressed by the FSB and there are several examples of these actions being taken in recent years, including with respect to incentives. The sectoral legislation and the JSE Rules all address conflicts of interest and require identification, avoidance, management, mitigation and disclosure, with the exception of CISCA where the provisions are much more high level than in other sectoral legislation. Where disclosure is required, it must be made in documents that are made available to</p>

	<p>affected clients.</p> <p>There is a general need for an FSB-wide process that would survey the broad marketplace on a proactive basis to ensure issues of concern, such as emerging conflicts of interest, are identified and addressed early.</p>
<b>Principles for Self-Regulation</b>	
<b>Principle 9.</b>	Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p><b>Self-regulation in South Africa</b></p> <p>The South African securities regulatory framework requires exchanges, CSDs and independent clearing houses to be licensed under the FMA. To be licensed, they are required to carry out certain self-regulatory tasks, although they are no longer formally referred to as self-regulatory organizations (SROs) in the FMA.<sup>25</sup> JSE and Strate are currently the only market infrastructures in South Africa that have self-regulatory responsibilities. SAFCOM is only an associated clearing house and is not required to undertake any such responsibilities. Strate's self-regulatory functions are also limited to its CSD participants, since it also acts only as an associated clearing house of the JSE for bonds rather than as an independent clearing house.</p> <p><i>Exchanges</i></p> <p>Section 10 of the FMA includes the self-regulatory tasks that a licensed exchange has to undertake:</p> <ul style="list-style-type: none"> <li>• Issue exchange rules;</li> <li>• Supervise authorized users'<sup>26</sup> compliance with the exchange rules and the exchange directives;</li> <li>• Supervise compliance by issuers of listed securities with the exchange's listing requirements.</li> <li>• Supervise authorized users' and issuers' compliance with the FMA, report any non-compliance to the Registrar and assist the Registrar in enforcing the FMA; and</li> </ul>

<sup>25</sup> The requirement to carry out self-regulatory tasks does not apply to associated clearing houses and trade repositories regulated under the FMA.

<sup>26</sup> The FMA uses the term authorized user for exchange members.

	<ul style="list-style-type: none"> <li>• Enforce the exchange rules, directives and listing requirements.</li> </ul> <p>The exchange rules must provide for:</p> <ul style="list-style-type: none"> <li>• Equitable criteria for authorization and exclusion of authorized users, including fitness and propriety requirements for authorized users and their managers;</li> <li>• The authorization and criteria for authorization of the securities services that authorized users or different categories of authorized users may provide in different categories of securities;</li> <li>• Prudent capital adequacy, guarantee and risk management requirements for (various categories of) authorized users; and</li> <li>• An efficient, honest, transparent and fair manner in which and terms and conditions subject to which transactions in listed securities must be effected by authorized users, whether for own account or on behalf of other persons.</li> </ul> <p>As required in Section 11 of the FMA, a licensed exchange must also make listing requirements that prescribe, among other issues:</p> <ul style="list-style-type: none"> <li>• The requirements with which issuers of listed securities and of securities which are intended to be listed, as well as such issuers' agents, must comply;</li> <li>• The standards of conduct that issuers of listed securities and their directors, officers and agents must meet; and</li> <li>• The standards of disclosure and corporate governance that issuers of listed securities must meet.</li> </ul> <p>Further, Section 17 of the FMA requires that the exchange rules must provide for:</p> <ul style="list-style-type: none"> <li>• The manner in which the exchange monitors its authorized users' compliance with the FMA, the exchange rules and the exchange directives;</li> <li>• Surveillance of any matter relevant for the purposes of the FMA, the exchange rules and the exchange directives; and</li> <li>• The steps to be taken by the exchange or its delegate to investigate and discipline an authorized user or officer or employee of an authorized user who contravenes or fails to comply with the exchange rules, the interim exchange rules or the exchange directives and how the exchange is obliged to furnish a report on such disciplinary proceedings to the Registrar within 30 days after the completion of such proceedings.</li> </ul> <p>Similar provisions on investigating and disciplining issuers and their directors, officers and employees have to be included in the listing requirements (Section 11 FMA).</p> <p><i>Central securities depositories and clearing houses</i></p> <p>Section 30 of the FMA includes the self-regulatory tasks that a licensed CSD has to undertake:</p>
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- Issue depository rules;
- Supervise its participants' compliance with the FMA, report any non-compliance to the Registrar and assist the Registrar in enforcing the FMA;
- Supervise participants' compliance with the depository rules and the depository directives; and
- Enforce the depository rules and the depository directives.

Section 35(2) of the FMA requires the depository rules to provide for equitable criteria for authorization and exclusion of participants, including fitness and propriety requirements for participants and their managers. The rules must also cover the steps to be taken by the CSD or its delegate to investigate and discipline a participant or officer or employee of a participant who contravenes or fails to comply with the depository rules, the interim depository rules or the depository directives and how the CSD is obliged to furnish a report on such disciplinary proceedings to the Registrar within 30 days after the completion of such proceedings.

Similar requirements are included in Sections 50(3) and 53(2) of the FMA for clearing houses. The clearing houses rules must also provide for the authorization and criteria for authorization of the clearing and/or settlement services that clearing members or different categories of clearing members may provide in different categories of securities as well as prudent capital adequacy, guarantee and risk management requirements for (various categories of) clearing members. If there are different categories of clearing members, the rules have to enable the restriction of the activities of such categories subject to different conditions.

#### *Disciplinary measures*

For any contravention of or failure to comply with the listing requirements, any one or more of the following penalties may be imposed:

- A reprimand;
- A fine not exceeding ZAR 7.5 million, to be adjusted by the Registrar annually to reflect the Consumer Price Index, as published by Statistics South Africa;
- Disqualification, in the case of a natural person, from holding the office of director or officer of a listed company for any period of time;
- Suspension or termination of listing; or
- Any other penalty that is appropriate in the circumstances.

According to Section 71(6) of the FMA, the market infrastructure rules may also prescribe that the market infrastructure, or a person to which it has delegated its disciplinary functions, may where appropriate impose any one or more of the following penalties for any contravention of the rules or failure to comply with them:

- A reprimand;

- A censure;
- A fine not exceeding ZAR 7.5 million, to be adjusted by the Registrar annually to reflect the Consumer Price Index, as published by Statistics South Africa;
- Suspension or cancellation of the right to be a clearing member, an authorized user or a participant;
- Disqualification, in the case of a natural person, from holding the office of a director or officer of a clearing member, an authorized user or a participant for any period of time;
- A restriction on the manner in which a clearing member, an authorized user or a participant may conduct business or may utilize an officer, employee or agent;
- Suspension or cancellation of the authorization of an officer or employee of a clearing member, an authorized user or a participant to perform a function in terms of the rules; or
- Any other penalty that is appropriate in the circumstances.

#### **Licensing requirements for the self-regulatory functions of a market infrastructure**

A licensed exchange must conduct its business in a fair and transparent manner with due regard to the rights of authorized users and their clients (Section 10(1) FMA). Section 8 of the FMA sets out the requirements applicable to an applicant for an exchange license and a licensed exchange. With regards to their self-regulatory functions, an applicant for an exchange license and a licensed exchange must:

- Have made arrangements for the efficient and effective surveillance of all transactions effected through the exchange and for the supervision of authorized users so as to identify possible market abuse and ensure compliance with the exchange rules, the exchange directives and the FMA;
- Have made arrangements for the efficient and effective monitoring of compliance by the issuers of listed securities with the exchange's listing requirements; and
- Have made arrangements for the efficient and effective supervision of authorized users so as to ensure compliance with the Financial Intelligence Centre Act 38 of 2001 (FICA).

Section 28(1)(d) of the FMA provides that an applicant for a CSD license and a licensed central securities depository must have made arrangements for the efficient and effective monitoring of compliance by participants with the depository rules. Similar requirements apply to the applicants for the license of an independent clearing house that are required to have made arrangements for the efficient and effective supervision of clearing members so as to ensure compliance with the clearing house

rules, the clearing house directives and the FMA.

Board Notice 104 of 2013 sets out the requirements applicable to the granting of a market infrastructure (i.e., exchange, CSD and independent clearing house) license and requires that the business plan of the applicant, which has been approved by its Board, deals at least with the following matters:

- Plans to ensure the integrity of the market and its authorized users, participants, external central securities depositories, other persons or clearing members;
- The surveillance procedures established to ensure the compliance by authorized users, participants, external central securities depositories, other persons and clearing members with the FMA and the proposed rules and directives of the market infrastructure and the resources of the applicant available to perform this function; and
- Procedures to be followed to effectively discipline the applicant's authorized users, participants, external central securities depositories and clearing members who fail to comply with the rules of the market infrastructure.

### **Supervision by the FSB**

#### *Rule approval*

The rules of a market infrastructure must be approved by the Registrar according to the process described in Principles 4 and 34. The same process applies to an exchange's listing requirements (Section 11(6) FMA).

#### *Other supervision*

The supervision of exchanges has been described in Principles 33 and 34. The reporting requirements applicable under Section 69 of the FMA and the requirement to submit certain documents to the Registrar under Section 70(2) of the FMA apply also to a CSD (Strate) and any future independent clearing houses. Their rules are also subject to the approval of the Registrar. As in the case of the JSE, the FSB representatives attend the Strate Board and Board Committee meetings as well as those of Strate's Participant Failure Committee. Strate is subject to the requirement to prepare an annual self-assessment. The FSB also conducts on-site visits at Strate; the latest visit focused on Strate's participant supervision.

### **Power of the Registrar to assume the responsibility for self-regulatory functions**

Section 10(3) of the FMA provides that the Registrar may assume responsibility for one or more of the exchange's regulatory or supervisory functions, if he/she considers it necessary in order to achieve the objectives of the FMA. Before assuming responsibility for a function, the Registrar must inform the exchange of his/her intention to assume the responsibility, give the exchange the reasons for the intended assumption, and call upon the exchange to show cause within a period specified by

the Registrar why responsibility should not be assumed by the Registrar. The same possibility applies to the regulatory and supervisory functions of a CSD and independent clearing house under Sections 30(3) and 50(3), respectively.

#### **Professional standards**

Section 73 of the FMA includes the confidentiality provisions applicable to market infrastructures. No market infrastructure or its Chief Executive Officer, other officer, employee, representative or member may disclose to any person any confidential information obtained in the performance of functions under the FMA, unless:

- The person to whom the confidential information relates has given consent;
- Disclosure is required or permitted under a law or a court order;
- Disclosure is necessary to carry out his, her or its functions or in the course of performing duties under any law; or
- Disclosure is required for the purposes of legal proceedings.

In addition, a market infrastructure may disclose information relating to or arising from its functions to any market infrastructure or supervisory authority, whether domestic or foreign, if such disclosure will further one or more of the objectives of the FMA.

The market infrastructures also apply procedural rules comparable to those of the FSB. For example, the JSE Equities Rules provide that a Disciplinary Committee may not impose any penalty unless the alleged improper conduct has first been put to the person who is alleged to have committed it and such person has been given an opportunity, orally or in writing, of explaining his/her conduct after being warned that any explanation furnished pursuant to the rules may be used in evidence against him/her. Any person in respect of whom a Disciplinary Committee has imposed a reprimand, censure, or fine (but not a warning) has the right to demand, within a period of three days after the imposition of such reprimand, censure or fine, that the matter be heard by a Tribunal. The Tribunal may, if it finds the person guilty of the conduct that forms the subject of the charge, impose a penalty more severe than that imposed by the Disciplinary Committee. Similarly, Sections 12.2 and 12.3 of the Strate Rules include a requirement to include reasons in the notice on planned enforcement action and provide the participant with an opportunity to make representations.

#### **Conflicts of interest**

Section 62 of the FMA includes provisions on conflicts of interest. A market infrastructure must, where applicable, take necessary steps to avoid, eliminate, disclose and otherwise manage possible conflicts of interest between its regulatory functions and its commercial services, which must include the implementation of appropriate documented and publicly available arrangements complying with the requirements prescribed by the Registrar. A market infrastructure must also conduct an annual assessment, in the manner prescribed by the Registrar, of such

arrangements and publish the results. FSB Board Notice 101 requires a market infrastructure to report in its annual report on the results of the annual assessment of its conflict of interest arrangements.

In order to give effect to section 62 of the FMA, in July 2013 the Registrar requested both the JSE and Strate to demonstrate that they had mapped their conflicts of interest and had arrangements in place to manage these conflicts. The FSB has prepared a draft Board Notice on conflicts of interest, which is however not yet in force.

In relation to the self-listing of securities issued by the exchange, Board Notice 95 of 2013 requires the controlling body of an exchange to:

- Implement appropriate arrangements to ensure that no real or potential conflict of interest arises with respect to such inclusion;
- Consider all complaints by affected persons relating to a conflict of interest;
- Determine whether a conflict of interest has arisen or may arise; and
- Report all complaints received in connection with a conflict of interest to the Registrar as soon as reasonably possible after the receipt of the complaint. The report by the controlling body must include all material facts, together with proposals for the resolution of any conflict of interest.

In practice, the JSE and FSB have minimized the most significant conflicts by having the FSB act as listing authority for the JSE's shares listed on the exchange. The FSB thereby ensures the Listing Requirements are met by the JSE as an issuer.

The exchange must include in its annual report to the Registrar a section on the regulatory and supervisory structure applicable to and the role of the Registrar in supervising the exchange's own listing, which section must include a statement to the effect that in the opinion of the controlling body, the exchange has complied with all its rules, listing requirements and procedures in a manner which warrants the continued listing of the exchange's securities on the exchange and a confirmation that all complaints relating to a conflict of interest were referred to the Registrar during the year under review.

During 2011 a new JSE Board Committee, the SRO Oversight Committee was created. It serves as an independent check on the appropriateness of the JSE's SRO activities and the manner in which JSE manages its conflicts of interest. It also creates a reporting line between the SRO focused divisions of the JSE, namely the Issuer Regulation and Market Regulation (Surveillance Divisions), and the JSE Board, which is in addition to the direct reporting line between the Chief Executive Officer and the heads of these divisions.

The Committee reports to the JSE Board on a biannual basis and has broad powers to require input from the heads of the two regulatory divisions and any other JSE staff.

The Committee's report is published in the JSE's Annual Report, submitted to the FSB

	and published in the FSB's Annual Report. These documents are available to the public on the respective organization's website.
Assessment	Fully Implemented
Comments	
<b>Principles for the Enforcement of Securities Regulation</b>	
<b>Principle 10.</b>	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	<p><b>Powers to inspect and obtain information</b></p> <p>Under section 4(5)(a) of the FAIS Act the Registrar may:</p> <ul style="list-style-type: none"> <li>• Conduct an on-site visit under Chapter 1A of the Protection of Funds Act; or</li> <li>• Instruct an inspector to conduct an inspection under the Inspection Act.</li> </ul> <p>The language in section 95 of the FMA gives the Registrar these same powers with respect to entities governed by that Act, as does section 14(1) of CISCA for its regulated entities.</p> <p>The relevant provisions do not require the Registrar to give prior notice to the entity. The Registrar may use these provisions to conduct on-site visits for general supervisory purposes or in order to investigate suspected non-compliance and contraventions. The Protection of Funds Act powers are used for routine inspection/examination type activities. The Inspection Act authority is aimed more at forensic investigations to be used for enforcement actions. The FSB refers to these as on-site visits and inspections, respectively.</p> <p>Under section 4A of the Protection of Funds Act, the Registrar may conduct an on-site visit of any regulated entity and has full access to the books and records of regulated entities under all of the FMA, FAIS Act and CISCA, both for routine supervision and for particular matters. The Registrar can also instruct any person that is in possession of any business document relating to the business of the regulated person to produce the document or furnish information about it.</p> <p>Under the Inspection Act, the inspector may summon any person (regulated or not), whom the inspector thinks may have possession of books and records of a regulated firm and require that person to produce the information (sections 4 and 5). These inspections involve a systematic process of collecting evidence relevant to the areas under review. While performing these inspections, staff may conduct specific actions such as execute search warrants and perform search and seizures.</p> <p>Under the FAIS Act, the Registrar may direct an FSP, representative or compliance officer to furnish the Registrar, within a specified period, with specified information or</p>

documents (section 4(2)). Further, section 6(3)(d) of the FMA stipulates that in performing its functions the Registrar “may require any person, including a regulated person, to furnish the Registrar, within a specified period, with specified information or documents.”

The JSE Equities Rule 12.10 (Surveillance and Investigation by the JSE Surveillance Department) provides for the inspection by the JSE Surveillance Department of the members of the JSE regarding their compliance with the FMA, the JSE Equities Rules, the JSE Equities Directives and the FICA. These rules are stated broadly and there is no requirement for notice prior to an on-site visit.

The JSE’s powers of investigation set out in Equities Rule 12.10.2.1.5 allow for the Director: Surveillance and any other person designated by him to call for any person who is subject to the jurisdiction of the JSE who is believed to be able to furnish any information on the subject of any investigation or to have in his or her possession or under his or her control any book, document, tape or electronic record or other object which has a bearing on the subject of the investigation to produce such book, document, tape or electronic record or object. An investigation is not limited to one in which there is suspected misconduct. It includes any enquiry to assess compliance with a regulatory requirement. The JSE’s powers of investigation also apply to requests for data and information that is required in respect of investigations that are conducted on a scheduled and on-going basis.

### **Surveillance of trading**

While the FSB lacks direct online access to the JSE surveillance system, its Market Abuse Department staff meet with the JSE market surveillance team on a biweekly basis to review information compiled by the JSE and are able to request at any time any needed information from the JSE. The FSB retains exclusive responsibility to monitor trading in the JSE shares that are listed on the JSE. An experienced FSB employee is assigned to monitor this trading.

The DMA has extensive and intrusive investigation powers to investigate market abuse (insider trading, market manipulation and false and misleading statements) under section 84 of the FMA. These investigation powers include:

- Summoning any person to provide any information regarding an investigation into market abuse;
- Interrogating any person under oath; and
- On the authority of a warrant, without prior notice, entering and searching the premises of any person, and seizing relevant documentation.

The JSE and Strate are responsible for the surveillance of their authorized users and participants respectively. Equities Rules 12.10.1.1 and 12.10.1.2 permit the JSE Surveillance Department to set up and maintain systems for market surveillance and compliance monitoring. See the description of these systems in Principles 9, 34, and 36.

**Record-keeping requirements**

All of the FAIS Act, the FMA and CISCAs set high-level record-keeping requirements for entities registered under those statutes (FAIS Act sections 18 and 19, FMA section 90, CISCAs sections 4 and 74) and require records to be kept for a minimum of five years.

Section 18 of the FAIS Act requires FSPs to keep and maintain records for a minimum period of five years regarding:

- Known premature cancellations of transactions or financial products by clients of the provider;
- Complaints received together with an indication whether or not any such complaint has been resolved;
- The continued compliance with the fit and proper requirements;
- Cases of non-compliance with the FAIS Act, and the reasons for such non-compliance; and
- The continued compliance by representatives of the authorized FSP with the requirements of the FAIS Act.

Board Notices made under the FMA and FAIS Act set out much more detailed requirements. Board Notice 96 of 2013 (that applies to JSE member firms, the JSE and Strate) requires that the accounting records of a regulated person must show the transactions and financial commitments of a regulated person, and the transactions and payments relating to clients in such a manner that they disclose with substantial accuracy the financial position, performance and cash flows of the regulated person, and separately, the position of clients of the regulated person, at the close of business on any day (section 2(1)).

It further states that a regulated person may keep computerized records provided that such records are subject to acceptable back-up and recovery procedures and can be reproduced in printed form. See also section 3(2) of the General Code of Conduct.

In particular, section 6 of Board Notice 96 of 2013 requires an authorized user, participant and clearing member to maintain, where applicable, extensive accounting records in respect of securities services provided, which, among other things, must contain as a minimum:

- A daily record of all sums of money received and expended;
- A record of funds held in trust;
- A record of all income and expenditure;
- A record of all assets and liabilities, including any provisions for financial commitments or contingent liabilities;
- A record of all purchases and sales of securities which reflects the:

- Date and time of each transaction;
- Person from whom securities were bought or to whom they were sold unless it is processed through an automated trading system recognized by the relevant exchange;
- Name of the person on whose behalf the securities were bought or sold;
- Quantity and description of the securities which were bought or sold;
- Name of the issuer of the securities;
- Price per security and the total consideration;
- Fees and charges;
- Taxes that are payable in respect of each transaction;
- Terms of the contract;
- Capacity (principal or agent) in which the transaction was entered into;
- A record of all securities and documents of title which are in the possession, safe custody or under the control of the authorized user, participant or clearing member in which is reflected the:
  - Name of the issuer of the securities;
  - Quantity and description of the securities;
  - Identification numbers of the securities and documents of title, where applicable;
  - Name of the registered holder and, if the registered holder is a nominee controlled by the regulated person, the name of the person on whose behalf the nominee is holding the securities;
  - Person from whom the securities were received and to whom they were delivered;
  - Date of receipt and delivery;
  - Location where the securities or documents of title are kept;
  - Details of any pledge to which the securities may be subject;
  - Person on whose behalf securities or documents of title have been received or delivered; and
  - Purpose for which the securities or documents of title are held.

The JSE Rules also set out very detailed requirements for the records to be kept by member firms. The Equities Rules specify the requirements for the maintenance of client records (Rule 8.10.4) and that members are directed to retain all instructions given by clients to execute transactions for a period of at least six months after the

relevant transactions (Rule 8.10.4.5). They also stipulate that all other client records be kept for at least five years after the rendering of the services concerned. Similar requirements are imposed on members under Rule 10.20 of the JSE's IRC Rules and Rule 16.10.5 of the Derivatives Rules.

Equities Directive DA1 also requires a member to "maintain accounting records on a continual basis so that at all times its records are up-to date" (section 1.1) and sets out additional requirements with respect to the firm's accounting records. Similar requirements apply under the Derivatives Rules and the IRC Rules.

No detailed record-keeping requirements have been set under CISCA for CIS managers to supplement the very general requirement in section 4 of that Act that a CIS manager keep proper records. However, CIS managers are subject to the record-keeping requirements set out in FICA (see below).

### **Client identity**

The record-keeping provisions mentioned above specifically require entities regulated under the FMA and FAIS Act to keep records of all clients.

JSE members are required by Equities Rule 8.60 to obtain and maintain client information for each account so as to identify their clients. Equities Rule 8.10.4 requires that such client records be appropriately maintained.

Section 56 of the Companies Act deals with beneficial ownership of companies subject to that statute. It allows for shares to be held in the name of one person for the beneficial interest of another. The provision stipulates that the identity of the ultimate owner of the security must be disclosed to the company and provides for the manner of disclosure. A regulated company<sup>27</sup> is required to maintain a register of such disclosures and to publish in its annual financial statements a list of the persons who hold beneficial interests of five percent or more of the total number of securities of any class issued by the company, together with the extent of those beneficial interests. These registers are open to access by the public.

Section 22 of FICA places an obligation on accountable institutions (which term includes all securities FSPs, regulated entities under the FMA, and CIS managers other than those that manage participation bond CIS) to keep information and verification documents obtained to establish their clients' identities. The information must be kept for a period of at least five years from the date on which the business relationship is terminated. Section 45(1) of FICA empowers the FSB to supervise and enforce compliance with FICA on all accountable institutions regulated by it. Further, to ensure on-going compliance with the fit and proper requirements, the Registrar has made it compulsory for FSPs to have policies, procedures and systems in place to comply with

<sup>27</sup> Regulated companies are defined in sections 117 and 118 of the Companies Act to include public companies, state-owned companies unless exempted, and certain private companies.

	<p>FICA and other anti-money laundering legislation (Fit and Proper Notice, Part IV).</p> <p>Under FICA, accountable institutions are required to have procedures in place to ensure that they regularly monitor transactions and business relationships with clients, having regard to the risk of money laundering and terrorist financing. By establishing and verifying the identity of clients (section 21) and keeping records of verification documents in accordance with section 22 of FICA, accountable institutions are able to identify unusual and suspicious transactions (section 29), cash transactions above ZAR 25,000 (section 28), and property related to terrorist financing activities (section 28A). These suspicious transactions must be reported to the FIC.</p> <p>Under section 45 of FICA, the FSB has authority to conduct routine inspections on the premises of its accountable institutions to determine their compliance with FICA and the relevant regulations. During the inspections, the FSB may conduct walk-through tests on systems and controls and also scrutinize the verification documents obtained by the accountable institution to establish the identity of clients.</p> <p>The JSE has the authority to request client particulars under Equities Rule 8.10.4.4, which states that client particulars must be made available for investigation within seven days of a request by the JSE. In practice, the surveillance systems maintained by the JSE contain all the prescribed client particulars.</p> <p><b>JSE and Strate supervision</b></p> <p>The FMA assigns some supervisory responsibilities to the exchange (JSE) and CSD (Strate). The FSB supervises their compliance with these responsibilities. The FSB has full access to information at the JSE and Strate under section 6(3) of the FMA.</p> <p>The Registrar has the authority under section 96 of the FMA to order changes to the market infrastructures' processes. After an on-site visit or inspection, the Registrar may direct the regulated entity to:</p> <ul style="list-style-type: none"> <li>• Take any steps or cease carrying on any act, in order to terminate or remedy any irregularity or state of affairs disclosed by the on-site visit or inspection; or</li> <li>• Prohibit or restrict specified activities of a director, managing executive, officer or employee, if the Registrar believes that he/she is not fit and proper to perform such activities.</li> </ul> <p>The JSE and other market infrastructures such as Strate are subject to confidentiality requirements under the FMA (see Principle 9).</p> <p>See also the discussion under Principles 9, 33 and 34 regarding the supervision of the JSE and Strate.</p>
Assessment	Broadly Implemented
Comments	The powers of the Registrar under the FMA and FAIS Act and those of the JSE under its rules to supervise their respective firms are extensive, as are the record-keeping

	<p>requirements that apply. However, there are some gaps under CISCA that are notable when compared to the requirements and powers available under the FMA and FAIS Act. Each Registrar under the FMA, FAIS Act and CISCA should have equivalent powers. While firms authorized under the FMA, FAIS Act and CISCA are subject to the same record-keeping requirements under FICA, they should also be subject to an equivalent level of detailed record-keeping requirements under their authorizing Acts.</p>
<b>Principle 11.</b>	The regulator should have comprehensive enforcement powers.
Description	<p>As noted above, the FSB has authority under the FSB legislation to conduct on-site visits of regulated entities or conduct investigations of any party (called inspections in South Africa) and to take action where non-compliance with the laws is found.</p> <p>The Registrar of FAIS has the power to investigate complaints of non-compliance with legislation, and, in complex or serious cases, appoint inspectors under the Inspection Act to conduct inspections into the activities of entities suspected of being in contravention. These powers are not limited to licensed firms. The Registrar may withdraw or suspend licenses or approvals and debar individuals in appropriate circumstances. (See also the discussion under Principle 29.)</p> <p>Under CISCA, the Registrar of CIS has powers to conduct an investigation, to impose fines, and to request an audit of a CIS manager. The Registrar is also empowered to call for an inspection or investigation into the affairs of a CIS manager (section 14) and may apply to court for an order to wind up the manager or the CIS, to appoint a new trustee or manager, or to appoint a curator in respect of the manager's business (section 15).</p> <p>The DMA has the power to investigate any person for the types of market abuse set out in Chapter X of the FMA, which include insider trading (section 78); false, misleading or deceptive statements (section 81) and market manipulation (section 80). Front-running client trading is also prohibited for FSPs under section 3(1)(f) of the General Code of Conduct. The Registrar may give instructions to investigate any misconduct by financial advisers, investment managers, etc.</p> <p>Section 94(1) of the FMA gives the Registrar authority to investigate a failure to comply with the FMA and sets out the powers of the Registrar, if non-compliance is found. These powers include the right to apply to court to wind up a company under the Companies Act, apply for the appointment of a curator, issue a compliance order, or forward the matter to the criminal enforcement authorities (section 96). The courts have the authority to declare a person disqualified for a definite or indefinite period of time.</p> <p>Under the Protection of Funds Act, the Registrar may take various actions, including:</p> <ul style="list-style-type: none"> <li>• Apply to the High Court for the appointment of a curator to take control of and manage the whole or any part of a regulated firm;</li> </ul>

- Agree with a regulated firm to appoint a statutory manager for that firm;
- Institute proceedings in the High Court to compel a regulated firm to comply with the law or any lawful request or instruction issued by the Registrar; and
- Seize assets or prevent the dissipation or destruction of assets or evidence (section 6).

Decisions of the Registrar under the FMA, FAIS Act and CISCA are appealable to the Appeal Board. The decisions of the Appeal Board are subject to review by the High Court.

To aid in effective enforcement, the Protection of Funds Act established the EC. The EC is an administrative body charged with adjudicating on all alleged contraventions of and non-compliance with legislation, regulations, codes of conduct, etc. administered by the FSB (section 6D(1) of the Protection of Funds Act). The Board of the FSB appoints the EC. Members are appointed for their knowledge and experience (with reference to the different industries). In addition, the chairperson and deputy chairpersons must either be advocates or attorneys with more than 10 years experience, or judges.

Where there is evidence of breach of or non-compliance with the requirements under the laws, the Registrar has the authority to refer matters to the EC. This evidence may come from routine supervisory activities, such as on-site visits, or an inspection under the Inspection Act.

If the EC determines a respondent has contravened a provision of FSB legislation, it may:

- Require the person to pay a sum of money to the FSB; there is no upper limit to the amount of such penalty;
- Order the person to pay compensation to make good the loss or damages suffered by the affected parties;
- Order a person guilty of insider trading to pay to the FSB a sum of up to ZAR 1 million plus three times the profit made or loss avoided (as set under section 82 of the FMA); and
- Make a cost order covering the cost of constituting the EC panel and all expenses reasonably incurred by the Registrar or DMA in investigating the alleged non-compliance and referring the matter to the EC (section 6D).

The EC's orders are enforceable as if they were judgments of the High Court of South Africa. Section 6D(3) of the Protection of Funds Act sets out some of the factors that the EC may take into account when it decides on a penalty, which include the nature and seriousness of the contravention, the impact, the entity's previous conduct, the extent of the profits derived, etc.

At any time prior to a referral of a matter to the EC or during or after EC proceedings,

the matter may be settled by written agreement (section 6B(7)). This agreement must be filed with the Chairperson and made an order of the EC. Approximately 80 percent of matters are settled in this way.

Decisions of the EC are appealable to the High Court.

#### **Transparency of sanctions imposed**

The practice of the FAIS Division is to publish every sanction decision. It also maintains a register of representatives of FSPs on its website that include the names of representatives who have been debarred. The CIS Division does not routinely publish penalties imposed.

All decisions of the EC (including settlements) are published on the FSB's website once the Chair of the EC issues the decision. A news release is also issued in all cases.

All Appeal Board hearings and those conducted by the EC are open to the public.

The JSE publishes all penalties other than private censures and even these are described on a no-names basis in public documents.

#### **Referral to criminal authorities**

The FSB may refer matters to the NPA and SAPS, e.g., under section 11 of CISCA and section 96(e) of the FMA. The FSB provides litigation support in these cases. The FSB does not have authority to institute a criminal prosecution itself.

Each of the statutes contains offenses provisions. The penalties that may be imposed vary from a fine of an unstated amount and a maximum of two years in jail under section 12 of the Inspection Act to a high of up to ZAR 50 million and up to ten years in jail under the market abuse provisions in section 109 of the FMA.

#### **Suspension of license or trading**

Section 16 of CISCA empowers the Registrar of CIS to cancel or suspend the registration of a manager. The Registrar of FAIS can suspend any license, if he/she is satisfied that the licensee has committed a material contravention of the FAIS Act.

The licensed exchange has the power to suspend trading of securities under section 12 of the FMA and must make rules regarding when such suspensions will be imposed.

Rule 6.10.6 of the JSE Equities Rules deals with the JSE Equities Trading system and provides that the Market Controller may:

- Decide that the market or segments of the market in equity securities be paused, suspended, halted or closed, if he is of the opinion that a fair and realistic market does not exist;
- Reduce or extend the hours of operation of the JSE equities trading system for any particular business day;

- Without prior notice to any person, pause, suspend, halt or close the JSE equities trading system for trading at any time and for any period; and
- Take such other steps as may be necessary to ensure an orderly market.

Section 12 of the Equities Rules contains provisions permitting the JSE to suspend a member for breaches of the Rules or when otherwise in default of its obligations.

Under the JSE Listing Requirements, the exchange has the general power to suspend the listing of any security on the exchange (sections 1.1-1.9), whether for failing to comply with the listing requirements, at the request of the issuer or for other reasons. The detailed listing rules set out when such actions will be taken and the process that will be followed.

#### **Access to information**

As noted under Principle 10, the Registrar has full access to information at regulated entities. In addition, the Registrar has the right to require third parties to appear and produce any relevant records under each of the FMA, the Inspection Act and the Protection of Funds Act. For example, section 6(3)(d) of the FMA says that in performing its functions the Registrar “may require any person, including a regulated person, to furnish the Registrar, within a specified period, with specified information or documents.”

Under the Inspection Act, an inspector may:

- Summon and interview under oath any person who has information relating to the inspection;
- Call for the delivery of any documentary evidence that has a bearing on the inspection; and
- Enter and search any premises, and seize any documentation relating to the inspection (in some instances a search warrant is required for this purpose).

#### **Private remedies**

Private persons may have rights under common law (such as for negligent misrepresentation) and by contract to take action for misconduct relating to the securities laws. These remedies would be based on the expectations imposed by the general law or the terms of the relevant contract and not on statutory contraventions of the securities legislation as such. Section 87 of the FMA protects the common law rights of persons aggrieved by any market abuse dealing or offence to sue for damages, except to the extent that any such amount has been recovered by the person under section 82 (liability for insider trading). Further, section 6I of the Protection of Funds Act provides that “no provision of the Act, whether it relates to civil or criminal matters, and no act performed under any such provision, may be construed as limiting any right of a person affected by the contravention to seek appropriate legal redress in terms of the common law or any other statutory law.”

	<p><b>Cooperation with other regulators</b></p> <p>If action must be taken by a regulator other than the FSB or JSE, both have the ability to share information with that other regulator. For example, under section 9 of the Inspection Act, the Registrar may disclose information to other regulators, organs of state and affected parties, if an offence has been committed or an institution is in an unsound financial condition. Generally, the Registrar may also share information with foreign regulators.</p> <p>Inspectors under the Inspection Act have wide powers to obtain information directly. However, if for some reason the inspector is unable to obtain the information directly, it may be obtained from any other domestic agency, by notice to such agency. There are MOUs that have been concluded between the FSB and other regulatory authorities for, inter alia, exchange of information. The investigative powers of the Inspectorate extend to information held by other agencies.</p> <p>See also the discussion under Principles 13-15.</p>
Assessment	Fully Implemented
Comments	<p>The FSB generally publishes all penalties imposed under the FMA and FAIS Act. The JSE publishes all penalties other than private censures and even these are described on a no-names basis in public documents. The exception to the general publication practice is under CISCA.</p> <p>The publication practices of the FSB should be uniform across the FSB Divisions.</p>
<b>Principle 12.</b>	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p><b>FSB routine supervisory framework</b></p> <p>In 2005, the FSB changed its supervisory approach from compliance-based supervision to risk-based supervision. The FSB put in place an agency-wide Policy Framework for Risk-Based Supervision (RiBS), the latest version of which was approved in 2011. The framework is intended to promote the early identification and on-going management of systemic and organizational risks at the regulated firms, allowing the FSB to focus its attention based on the risk profile of the firms.</p> <p>The policy document sets out the overall minimum standards that each division within the FSB is to adhere to when designing, implementing and maintaining its respective RiBS framework. It also sets out the basis for sharing of information and co-operation between departments where different licenses are issued to a single financial institution or group of financial institutions.</p> <p>RiBS is a structured approach designed with two aims:</p>

- Identify as early as possible, assess, prioritize and mitigate those important risks relevant to each institution that present the greatest financial risk to its continued viability and that may ultimately impede the ability of the FSB to attain its aims; and
- Create incentives for institutions to manage their risks effectively.

The key objectives of RiBS are to:

- Assess the safety and soundness of the regulated financial institutions;
- Intervene on a timely basis where practices of regulated financial institutions are imprudent or unsafe; and
- Ensure that enforcement and regulatory action is taken where institutions continue to be non-compliant despite being afforded the opportunity to correct the area of non-compliance identified.

These are achieved by evaluating an institution's risk profile, financial condition, risk management processes and compliance with applicable legislation.

RiBS follows a structured approach to consider all of the key aspects of a regulated entity's business and the risks that might have a material impact within each aspect. These are the risks that merit greater regulatory attention and that may require remediation at the regulated entity and/or intervention by the FSB.

Each Division within the FSB has developed its own approach in implementing RiBS. There are differences in the approaches due to the particular characteristics of each industry and inherent differences between prudential and market conduct regulation. However, the objectives of each of the approaches, the supervisory cycle that is followed and the end result of assigning a risk rating to each regulated entity are similar.

See the description of the individual divisions' supervisory activities set out below. The supervisory activities for CIS managers appear under Principle 24, that for market intermediaries in Principle 31, and that for the JSE and Strate in Principles 9 and 34.

#### **Unusual transactions at exchanges and trading systems**

As noted above, section 8(1) of the FMA requires an applicant for an exchange license and a licensed exchange to have systems in place "for the efficient and effective surveillance of all transactions effected through the exchange and for the supervision of authorized users so as to identify possible market abuse and ensure compliance with the exchange rules and exchange directives and this Act."

The JSE has a staff complement of experienced market surveillance personnel, with teams assigned to each of its trading markets (Cash Equities, Derivatives and Bonds) that monitor the markets on a continuous basis. The JSE trading systems can identify market participants and provide broad functionality to flag unusual trading patterns and JSE staff has the authority to immediately contact listed companies and

authorized users (members) for information or explanations of unusual trading or company activities.

The very detailed information kept on the JSE's systems allow the exchange to trace the execution of orders on its markets.

#### *Detection and enforcement*

The Market Abuse Department is a department within the Investment Institutions Division of the FSB. The department is responsible for investigating market abuse offences as defined in Chapter X of the FMA. Essentially, the Market Abuse Department carries out the mandate of the DMA to enforce the prohibitions against market abuse contained in the FMA.

The Market Abuse Department's staff is made up of investigators having either legal or accounting experience.

The role of the Market Abuse Department is to protect the integrity of the financial markets, thereby protecting members of the public and investing community who trade in securities listed on a regulated market.

The FMA sets out the market abuse offences. According to the FMA, market abuse offences/contraventions relate to companies whose securities are listed on a regulated market. The FMA sets out three market abuse offences namely insider trading (prohibited in section 78), market manipulation (prohibited in section 80), and false reporting/misrepresentations (prohibited in section 81) with respect to listed companies. (See also Principle 36.)

The Market Abuse Department will investigate a market abuse matter and report such to the DMA for it to make a decision to either close the case or refer it for enforcement action. During the past three years, the DMA finalized the following number of forensic investigations, relating to insider trading, market manipulation and false or misleading reporting.

#### **DMA Investigations**

<b>Year</b>	<b>Number</b>
2011	21
2012	15
2013	21

Source: FSB – DMA.

The majority of the DMA's investigations arise from referrals received from the JSE's Surveillance Department and Issuer Regulation Department as well as complaints from members of the public. Most of the matters were detected via the JSE surveillance systems. The DMA investigators and the JSE surveillance staff meet bi-weekly to consider surveillance results and the progress of cases under investigation.

After meeting with the JSE departments, cases are logged and allocated to an investigator. The investigator requests all relevant documents and information,

subpoenas witnesses and suspects for interrogation and then drafts a forensic report to be presented to the DMA.

The DMA has quarterly meetings and after each meeting it issues a press release updating the public on the status of its current investigations. The determination of the EC in respect of matters referred to it by the DMA for enforcement action is also published once a matter has been finalized.

During the 2012/2013 financial year, the DMA held three meetings. It considered 17 completed investigations. Of the 17 cases, 11 were closed. Investigations are closed once it becomes evident that no, or insufficient evidence, has been obtained to warrant action. The DMA was satisfied that anti-market abuse provisions were not contravened in all these cases.

The DMA referred six cases for enforcement action in the financial year 2012/2013. Four cases related to alleged market manipulation in the Afgri Limited, Metair Investments Limited, Palaborwa Mining Limited and Comair Limited shares. The other two cases related to false and misleading statements by Alliance Mining Corporation Limited and Africa Dawn Limited. The following administrative penalties were imposed:

- ZAR 10 million against two individuals for price manipulation in Afgri Limited, Metair Investments Limited, Phalaborwa Mining Limited and Comair Limited shares;
- ZAR 71,500 against two individuals for insider trading involving Africa Cellular Towers Limited shares; and
- ZAR 68,460 for insider trading involving Dimension Data Limited shares.

See also the discussion in Principle 36.

### **Investigations and enforcement actions**

#### *FSB*

In addition to the routine supervisory activities described above, the FSB also conducts inspections at FSPs to investigate allegations of wrongdoing brought to the Registrar's attention. The inspections may culminate in regulatory and enforcement action taken against the FSP.

The Enforcement Unit conducted the following inspections for this purpose:

#### **Inspections by Enforcement of FSPs**

Year	Number of Inspections
2011	14
2012	21
2013	12
2014 to March	9*

Source: FSB.

\* of which three have been completed.

The following tables set out the enforcement activities under the FAIS Act from July 1, 2011 to April 1, 2014.

#### Enforcement Activities Under the FAIS Act

Year	Investigations Received	Cases Closed	Outcome		Total Sanctions Imposed (Thousand ZAR)
			Finalized Penalties	Lack of Evidence	
2011	98	67	17	50	503
2012	132	97	24	73	5,375
2013	63	42	6	36	1,840
2014	26	20	1	19	50

Source: FSB.

\*Numbers from 2012 onward include cases carried over from the previous years.

Many of these matters were concluded by written settlement agreements. Penalties were imposed for breaches of the FAIS Act, Regulations or Codes of Conduct. Many of the offences related to carrying on activities without being licensed or selling/marketing products or services for unlicensed providers. Several other offenses involved failure to maintain liquidity, payment of prohibited incentives, other conflicts of interest and signing blank documents. The individual fines ranged from ZAR 10,000 to ZAR 1.5 million.

The Enforcement cases regarding CIS were fewer in number.

#### CIS Cases

Year	Number of cases	Breaches
2011	0	
2012	0	
2013	1	Marketing unauthorised foreign product
2014	1	Unauthorised name change

Source: FSB.

#### JSE

The responsibility for supervising compliance by authorized users of exchanges has been assigned to the licensed exchanges under the FMA. It is the JSE's responsibility to monitor, detect and investigate these matters with respect to its members. Applicants for an exchange license and licensed exchanges are required to have adequate mechanisms and procedures to address this.

Section 12 of the JSE Equities Rules deals with the exchange's supervision and enforcement powers and processes. It contains provisions permitting the exchange to suspend the membership of a member for breaches of the Rules or when otherwise in default of their obligations.

JSE Rule 12.30 sets out what constitutes improper conduct under the Equities Rules when committed by any person who at the time of the alleged act or practice was a

member or employee of a member. This conduct includes:

- Committing or attempting to commit any act which is dishonest or fraudulent;
- Contravening, attempting to contravene, or failing to comply with any one or more provisions of the FMA, a rule or a directive; and
- Negligently or recklessly conducting the business or affairs of the member in such a way that actual or potential prejudice is, or may be, caused to the JSE, any other member, a client of a member or the general public. The failure by a member to introduce appropriate and reasonable safeguards or controls to avoid such prejudice may be treated, where appropriate, as constituting either negligence or recklessness.

The Disciplinary Committee of the JSE may take action against anyone who was found committing improper conduct under Rule 12.40.2.2 of the Equities Rules and may impose the penalties deemed to be appropriate. These penalties may include a warning, reprimand, censure or imposition of a fine (with or without ordering that a contribution be made towards the JSE's costs) on any person who has, in the reasonable opinion of the Disciplinary Committee, been guilty of improper conduct.

The JSE would typically only take enforcement action against members, if the nature of the weaknesses in the member's arrangements was severe or if the weaknesses had resulted in some form of prejudice to clients.

The JSE enforcement figures for the last three years are as follows:

<b>JSE Enforcement Cases</b>			
<b>Nature of Misconduct</b>	<b>Period of Misconduct</b>	<b>Year Closed</b>	<b>Penalty Imposed</b>
Reckless trading by derivatives traders	Pre 2011	2013	Traders prevented from re-entering market
Client losses concealed by derivatives trader	Pre 2011	2013	Traders prevented from re-entering market
Cherry picking by derivatives trader	Pre 2011	2013	Traders prevented from re-entering market
Proprietary losses concealed by senior executive	Pre 2011	2012	No action. No rule breaches. Matter dealt with by member
Cherry picking by derivatives trader	Pre 2011	2014	Trader prevented from re-entering market
Cherry picking by derivatives trader	Pre 2011	2014	Trader prevented from re-entering market
Equities trader booking false transactions to clients	Pre 2011	Ongoing	
Senior executive booking trades at	Pre 2012	Ongoing	

	false prices Individual trading without registration	2011	2012	Individual to make submission if he attempts to register
	Bond firm making profits on agency transactions	Pre 2011	2013	No action. Insufficient evidence of misconduct
	Equity member and trader booking trades off market	Pre 2011	Ongoing	Member has withdrawn from market but trader to be charged
	Breaches of anti-money laundering requirements	2012	Ongoing	Enforcement action being considered by FSB
	Breach of client mandates by portfolio manager	2013	Ongoing	
Source: JSE.				
<b>System to respond to intelligence received</b>				
<p>The FSB receives information that might raise regulatory concerns from many sources including news media reports, complaints and tip-offs. This last could be a direct communication, or through the FSB Tip-Offs Anonymous hotline. The FSB also has a general e-mail address that enables the public to bring information under the attention of the regulator. Once received, these matters are allocated to the relevant FSB division. Outcomes from the Ombuds process are also shared with the relevant FSB division.</p> <p>Each division has its own complaints register in which the matters are recorded and tracked. The information is allocated to an analyst for evaluation, and if it seems as if it has merit, the Registrar may inter alia instruct an inspection into the matter. In such instance the relevant inspector will have all the Inspectorate powers at his or her disposal (i.e., interviews under oath, calling for documents, and search and seizure powers – with or without a search warrant).</p> <p>The internal auditors of the FSB do random sampling of complaints to ensure they are dealt with appropriately.</p>				
<b>Expected compliance systems</b>				
<p>In considering an application for approval, the Registrar must be satisfied that a CIS manager has in place appropriate internal policies and procedures for compliance with relevant legislation. See the discussion under Principle 24.</p> <p>An FSP under the FAIS Act with more than one key individual or representative must have a fit and proper compliance officer approved by the FSB to monitor the FSP's compliance with the law. The FSP must also have in place appropriate systems and procedures to be followed by it and any representative to ensure compliance with the FAIS Act (section 17). See also the discussion in Principles 29 and 31.</p>				

Rule 4.30 of the JSE Equities Rules makes provision for the appointment of compliance officers who are to assist the board of directors of the member in ensuring compliance by the member with the FMA and the JSE Rules and Directives. The person to be appointed as a compliance officer must be fit and proper. The compliance officer must:

- Implement the resources, systems and procedures required to promote and monitor compliance by the member and its employees with the FMA, the rules and the directives;
- Report to the Director: Surveillance any breaches by the member of the FMA, the rules and the directives or any other issue considered by the compliance officer to be irregular; and
- Ensure that the content of the JSE Gazettes is communicated to and understood by all relevant employees.

#### **Failure to supervise**

Sections 8 and 13 of the FAIS Act place an obligation on an FSP to supervise and oversee representatives acting on its behalf and to ensure their ongoing compliance with the fit and proper requirements. The FSP is responsible for the actions and omissions of its representatives.

Under section 14(1) of the FAIS Act, the FSP must withdraw the authority granted to any representative whom it has appointed to act on its behalf, if such representative contravened, failed to comply with or no longer complies with any provision of the FAIS Act, fit and proper requirements, applicable code of conduct, or other applicable laws. The FSP must inform the Registrar after taking such action against the representative and key individual of the representative.

However, section 14A of the FAIS Act empowers the Registrar to take direct action against an FSP's representative for contravening or failing to comply with the FAIS Act. In addition to that, the Registrar can also suspend or withdraw the license of the FSP under section 9 of the FAIS Act for the offences committed by the representative of such FSP.

Under Rule 3.30.1.2 of the JSE Equities Rules, a member must ensure that its employees are suitable, adequately trained and properly supervised. Failure to supervise an employee would be a breach of the member's obligations. The JSE may impose penalties on the member, its representatives or its officers and directors.

#### **Criminal enforcement**

As in many countries, the criminal enforcement of white collar crime has not been a high priority of the justice system and the number of successful criminal prosecutions is relatively small. This may be ascribed to a combination of factors, such as the complexity of some offences, a lack of training of prosecutors and police, and the difficulty of proving cases beyond a reasonable doubt.

	<p>In the period from 2011 to March 2014, the Enforcement Unit of the FSB has referred a total of 14 cases to the SAPS and/or the criminal prosecution authorities. Of these, one has lead to a conviction with a penalty of ZAR 10,000 and 6 months in jail; the other investigations are stated to be ongoing.</p> <p>In order to reduce these acknowledged impediments to criminal prosecution, the FSB actively engages the police and the NPA on issues relating to the FSB matters. It briefs the NPA, acts as expert witness and assists in training police investigators and prosecutors. The FSB has funded the production of expert witnesses for cases. The Enforcement Unit is building cooperative working relationships with the Special Commercial Crimes Unit (SCCU) of the NPA, the anti-corruption unit of SAPS and the Asset Forfeiture Unit (AFU) of the NPA. In one recent case (Ledimar Financial Services) the powers of the FIC were relied on to freeze assets of a pyramid scheme and then those of the AFU were engaged to get orders to preserve the assets and then seize the bank accounts in order to return the money to the investors who had been defrauded.</p> <p>Also, the SCCU has recently decided to increase its focus on crimes where the amount of money involved exceeds ZAR 5 million and is looking to the FSB to provide support to the SCCU for these prosecutions. Similarly, the police are increasingly targeting commercial crimes.</p> <p>Finally, the Ministry of Justice has established special commercial crimes courts with trained magistrates to hear these sorts of cases.</p>
Assessment	Broadly Implemented
Comments	<p>The key to Principle 12 is whether the regulatory system ensures an effective and credible use of all of its supervisory and enforcement powers. The results in South Africa are mixed.</p> <p>The expectations of the Assessment Methodology regarding supervision and surveillance are met with respect to the FAIS Division, Capital Markets Department, Market Abuse Department and the JSE. The routine supervisory activities of the FAIS Division and the JSE on their regulated entities are extensive and intensive. The JSE conducts detailed surveillance of its markets, under the supervision of the FSB. There are expectations for supervisory and compliance procedures at these regulated firms.</p> <p>Regulated firms that were interviewed agreed, without exception, that the FSB and JSE inspectors and reviewers were professional, experienced and knew the business of the firms they were examining.</p> <p>However, there are some concerns about the effectiveness of the supervisory program under CISCA. See the discussion in Principle 24.</p> <p>Further, in common with many countries, the jurisdiction's enforcement effectiveness is mixed. There have been some successes at the FSB through the EC process in</p>

	<p>enforcing breaches of the laws and material penalties have been obtained on some market abuse matters. However, the success of criminal enforcement has been limited. To be viewed as being fully implemented in this Principle, the expectation is that a reasonable number of prosecutions and criminal convictions must have been achieved. A conviction against an individual (even in the absence of a term of imprisonment) is seen as being a powerful deterrent. The challenge here, as in many jurisdictions, is that the regulator has little control over the criminal prosecution process and white-collar crime is often not a priority of either the police or prosecution. The Enforcement Unit is working on building its relationships with other key players in this area and this may well bear fruit in the future. Further, if the JSE enforcement process was swifter and the penalties imposed were more significant, the effectiveness of the program could be improved.</p>
<b>Principles for Cooperation in Regulation</b>	
<b>Principle 13.</b>	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	<p>The FSB has comprehensive authority to obtain and share information with domestic and foreign counterparts. Section 22 of the FSB Act governs the use and sharing of information. Subsection 22(1) imposes a general duty of confidentiality on the Board, its employees, members of committees, the Appeal Board or contractors, and others acting on behalf of the FSB regarding information obtained in the performance of any power or function under the FSB Act, the FSB legislation or sections 45 and 45B of FICA. Section 22(2) permits the use or disclosure of such information only in specified circumstances, which include:</p> <ul style="list-style-type: none"> <li>• In the course of performing functions under, or as enabled by the FSB legislation;</li> <li>• For the purposes of legal proceedings or other proceedings;</li> <li>• When required to do so by a court; or</li> <li>• By the Executive Officer or Deputy Executive Officer if in their opinion, disclosure is appropriate:             <ul style="list-style-type: none"> <li>• To a regulatory authority, for the purposes:                 <ul style="list-style-type: none"> <li>• Of ensuring that financial sector institutions conduct their business in a manner that is consistent with and promotes the objectives of consumer and investor protection, the fair treatment of consumers and investors, efficiency and integrity in financial markets and confidence in the financial system;</li> <li>• Of ensuring the safety and soundness of financial institutions, in particular the ability of financial institutions to meet the financial</li> </ul> </li> </ul> </li> </ul>

	<p>commitments and obligations they incur in the course of carrying out their business;</p> <ul style="list-style-type: none"> <li>• Of ensuring the stability of the financial system;</li> <li>• Of coordinating the supervision of financial institutions with other regulatory authorities;</li> <li>• For the purposes of disclosing to any regulatory authority in accordance with a cooperation agreement or otherwise, information relating to a particular financial or other institution, financial or other service or a particular individual who is or was involved in a particular financial institution or financial service, if that regulatory authority has a material interest in the information.</li> </ul> <p>Regulatory authority is defined very broadly to include both domestic and foreign regulators and domestic market infrastructures and comprises:</p> <ul style="list-style-type: none"> <li>• Any organ of state responsible for the supervision or enforcement of legislation, or a similar body designated in the laws of a country other than South Africa to supervise or enforce legislation of that country; and</li> <li>• A market infrastructure that is responsible for the supervision of persons authorized by such infrastructure under the FMA (FSB Act, section 22(5)).</li> </ul> <p>The sectoral legislation often contains similar provisions. For example, section 6(3)(e) of the FMA permits the Registrar, despite the provisions of any other law, to furnish information acquired by him/her under the Act to any person charged with the performance of a function under any law, including a supervisory authority.</p> <p>The FMA also empowers the JSE to share information with other regulators. Further, section 88 of the FMA authorizes the DMA to share information concerning any market abuse matter with any of: the institutions which have nominated persons to the Directorate; the TRP; the SARB; the IRBA; a licensed exchange, CSD or independent clearing house; the FIC; the National Treasury; the Minister of Finance; and the persons, domestic or foreign, responsible for regulating, investigating or prosecuting insider trading, prohibited trading practices and other market abuses.</p> <p>Under the Inspection Act, the Registrar may disclose information to other regulators, organs of state and affected parties, if an offence has been committed or an institution is in an unsound financial condition. The Registrar may also share information with other regulators, including foreign regulators (section 9). The FSB also has the power under section 3A of that Act to conduct an inspection for the purposes of assisting another regulator under an MOU or other agreement. The FSB has utilized this authority to subpoena witnesses and compel the production of documents at the request of another regulator, even when the inquiry concerns potential violations of foreign law that are not violations of South African law.</p> <p>Generally, the Registrar may disclose to or share information with foreign financial or</p>
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investment regulators in the proper performance of his/her functions for the purpose of legal proceedings, in the public interest, and in specific instances.

The FSB has the authority to share information both domestically and cross-border without seeking approval from external authorities. It can share information on request or on an unsolicited basis. There is no need for the conduct alleged by the foreign regulator to be a breach of the law in South Africa; that is, there is no requirement for dual illegality.

The FSB is a signatory to the IOSCO MMOU. Acceptance as a signatory requires a determination by IOSCO that the regulator has all necessary legal authority and complies with all relevant principles regarding cooperation and assistance with other regulatory authorities. The FSB is also a signatory to the South African Development Community (SADC) MMOU and has entered into bilateral MOUs with more than 75 foreign regulatory authorities. These MOUs are not published, although a list of the MOUs is posted on the website.

Intermediaries and market infrastructures operating in the jurisdiction are required to keep extensive records relating to their clients and transactions undertaken. These records include information identifying beneficial owners of accounts related to securities transactions and the information necessary to reconstruct transactions. The FSB has full access to these records. (See the discussion in Principle 10.) The FSB can share this information with other regulators under the authority granted in the legislation.

The IRBA, under section 47(5) of the APA may disclose information obtained during an inspection of a registered auditor to, among others, any appropriate regulator that requires it for the institution or an investigation with a view to the institution of any disciplinary action or criminal prosecution. This can only be done at the written request of that other regulator.

JSE Equities Rule 12.20 deals with the use of information obtained by the JSE Surveillance Department and referral to another authority.

12.20.1 Any information, document, book, tape or electronic record or other object obtained by the JSE Surveillance Department, whether by investigation or otherwise, may be used in evidence in any disciplinary proceedings contemplated in rule 12.40 and may be furnished by the JSE Surveillance Department to any other body which may have jurisdiction over the matter under consideration, whether outside or within the Republic.

12.20.2 If the JSE Surveillance Department become aware of any possible contravention of law by a person over whom the JSE does not have jurisdiction, the JSE Surveillance Department may refer such matter to the appropriate authority or authorities, whether outside or within the Republic.

There are similar provisions under the JSE's Derivatives Rules and IRC Rules.

	<p>As noted above, the information obtained by the FSB is subject to confidentiality requirements. Section 22(4) of the FSB Act provides that information may only be disclosed to another regulatory authority, if it is established that the regulatory authority that will receive the information has appropriate safeguards in place to protect the information, which safeguards must be similar to those required from the FSB. There are also requirements for assurance of confidentiality before such information can be provided to third parties (section 22(4)(b)).</p> <p>Information requested from or provided to another regulatory authority:</p> <ul style="list-style-type: none"> <li>• Must only be used for the purpose for which it was requested;</li> <li>• Must not be made available to third parties without the consent of the regulatory authority that provided the information;</li> <li>• If lawfully compelled to make information provided by a regulatory authority available: <ul style="list-style-type: none"> <li>• Inform that regulatory authority of the event and the circumstances under which the information will be made available; and</li> <li>• Where possible, use all reasonable means to oppose the disclosure of or protect the information (section 22(4)(d)).</li> </ul> </li> </ul>
Assessment	Fully Implemented
Comments	
<b>Principle 14.</b>	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>The FSB has wide authority under the FSB Act to enter into information sharing agreements with other regulators, both domestic and foreign.</p> <p>Section 22(3)(a)(v)(bb) of the FSB Act provides that the Executive Officer or a Deputy Executive Officer of the FSB may negotiate and enter into bilateral or multilateral cooperation agreements, including MOUs, with regulatory authorities to provide mechanisms for the exchange of information. Regulatory authority is defined to include both domestic and foreign regulators responsible for the supervision or enforcement of legislation and market infrastructures as defined in the FMA.</p> <p>See also the discussion in Principle 13.</p> <p>The FSB is a signatory to the IOSCO MMOU. The FSB is also a signatory to the SADC MMOU and has entered into many bilateral MOUs with foreign regulatory authorities.</p> <p>The International and Local Affairs Unit of the FSB was established in April 2012 and is responsible for dealing with requests for information from other regulators. Since that</p>

	<p>time there have been 186 requests for information. The processing of a request takes 3-15 working days after receipt.</p> <p style="text-align: center;"><b>FSB Information Requests Received</b> <b>April 1, 2012-March 31, 2014</b></p> <table border="1" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;">Nature of Request</th> <th style="text-align: center;">Number Received</th> </tr> </thead> <tbody> <tr> <td>Information only</td> <td style="text-align: right;">124</td> </tr> <tr> <td>Assistance to be provided by FSB</td> <td style="text-align: right;">18</td> </tr> <tr> <td>Completion of surveys and questionnaires</td> <td style="text-align: right;">44</td> </tr> <tr> <td>Total</td> <td style="text-align: right;">186</td> </tr> </tbody> </table> <p>Source: FSB.</p> <p>The FSB has not refused to provide information in response to a request from another authority that is a party to one of the MMOUs or MOUs signed by the FSB. If the request did not fall into the jurisdiction of the FSB, it was referred to the relevant entity.</p>	Nature of Request	Number Received	Information only	124	Assistance to be provided by FSB	18	Completion of surveys and questionnaires	44	Total	186
Nature of Request	Number Received										
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Total	186										
Assessment	Fully Implemented										
Comments											
<b>Principle 15.</b>	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.										
Description	<p>Most South African market participants are required to keep extensive records regarding clients and their transactions (see Principle 10). The FSB has full access to all records kept. Further, under the Companies Act, the names of all beneficial owners are required to be disclosed routinely and on demand to the company (section 56). The companies must keep records of these beneficial owners and the registers are public information accessible by all. In addition, the JSE's surveillance system can provide extensive details on trades.</p> <p>As a signatory to the IOSCO MMOU, the FSB can provide the assistance contemplated by Key Questions 2, 4, 5 and 6 without there being a need for the FSB to have an independent interest in the matter. If the FSB does not have the information, it may, under section 3A of the Inspection Act and section 95(2) of the FMA, conduct an inspection to obtain the needed information. Requests from foreign regulators are given priority.</p> <p>See also the discussion under Principles 13 and 14.</p> <p><b>Financial conglomerates</b></p> <p>The term financial conglomerate is not currently defined in South African financial sector legislation, and no formal group-wide supervisory framework for conglomerate supervision is in place. However, in practice an informal approach to supervision of the major financial conglomerates exists between the FSB and the Bank Supervision</p>										

	<p>Department (BSD) of the SARB. The FSB and BSD determine which groups are major financial conglomerates to which they will apply supervisory focus, and which authority will be the lead supervisor for the group. Group wide supervision of FSB regulated entities is currently undertaken on a moral suasion basis, which relies on the general authority and standing of the regulator rather than specific legislative provisions.</p> <p>The FSB is able to request information relating to financial conglomerates indirectly through regulated financial institutions under the authority afforded to the FSB in the sectoral legislation that it administers and is able to share such information with other regulators in accordance with section 22 of the FSB Act.</p>
Assessment	Fully Implemented
Comments	
<b>Principles for Issuers</b>	
<b>Principle 16.</b>	There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.
Description	<p>There are two regimes in South Africa that govern the disclosure of information by entities that issue securities to the public:</p> <ul style="list-style-type: none"> <li>• The disclosure obligations set out in the Companies Act and the related Regulations made under that statute that apply to all companies incorporated in South Africa; and</li> <li>• The obligations imposed on listed companies and applicants for listing by the JSE Listing Requirements.</li> </ul> <p>The CIPC (part of the DTI) has legal responsibility for company registration and disclosure under the Companies Act. The JSE Listing Requirements are issued by the JSE and approved by the FSB.</p> <p><b>Disclosure requirements</b></p> <p><i>Initial offerings</i></p> <p>The Companies Act states that only companies may make offers of securities to the public and contains detailed requirements that would have to be met by a corporate issuer. However, in practice, several other legal entities issue securities to the public, such as trusts issuing exchange-traded funds. If the instruments are listed on the JSE, the exchange's listing requirements would apply, regardless of the issuer's legal structure. If the issuer is a CIS, then CISCA would apply. If the issuer is not a company and the securities are not listed, it is not clear what regime would govern the offering.</p> <p>Under the Companies Act, an offer to the public generally must be accompanied by a prospectus that meets the requirements of section 100 of the Companies Act and the</p>

provisions set out in Part 4 of the Regulations. Under section 99, the prospectus, along with any material contracts, must have been filed with and registered by the CIPC, the responsible authority created under the Companies Act. Offerings, other than initial public offerings, by JSE listed companies are exempt from the Companies Act provisions, provided they meet the requirements set in the JSE Listing Requirements (section 99(3)(a)(i)).

Section 96 of the Companies Act lists certain transactions that are not public offerings under the statute and so exempt from the prospectus requirements. These include:

- Offers made only to sophisticated investors, such as financial institutions, exchange members, FSPs or entities registered with the SARB;
- Where the minimum block purchased as principal is at least ZAR 100,000;
- Rights offerings that meet prescribed terms and where the securities issued are to be listed;
- Sales to directors and prescribed officers;<sup>28</sup> and
- Transactions relating to employee share schemes.

Under section 100, every prospectus must contain all the information that an investor may reasonably require to assess the assets and liabilities, profit and losses, current financial position and prospects of the company as well as the securities being offered and the rights attached to them. It must also adhere to the more detailed requirements set out in the Regulations.

Section 56 of the Regulations provides that a prospectus must include all the material information concerning the offer, set out in separate sections. The order that information is presented is prescribed and each topic set out in the Regulations must be covered in a separate paragraph using the regulation heading as the paragraph title. The mandated information and format is:

- Section 1 — Information about the company whose securities are being offered:
  - Name, address etc. of the issuing company;
  - Details about the directors, company secretary, auditors, bankers and underwriters/stock brokers involved in the offering;
  - History, state of affairs and prospects of the company;
  - Share capital of the company;

<sup>28</sup> Under Regulation 38, a holder of a prescribed office is anyone who exercises general executive control and management over a company or a substantial part of the company's business, whether or not he/she is a director of the company.

- Options or preferential rights in respect of shares;
- Commissions paid or payable in respect of underwriting;
- Material contracts;
- Interest of directors and promoters;
- Loans;
- Shares issued or to be issued otherwise than for cash;
- Property acquired or to be acquired;
- Amounts paid or payable to promoters;
- Preliminary expenses and issue expenses (Regulations 57-69);
- Section 2 — Information about the offered securities
  - Purpose of the offer;
  - Time and date of the opening and of the closing of the offer;
  - Particulars of the offer;
  - Minimum subscription (Regulations 70-73)
- Section 3 — Statements and reports relating to the offer
  - Statement as to adequacy of capital;
  - Report by directors as to material changes;
  - Statement as to listing on stock exchange;
  - Report by the auditor where business undertaking will be acquired;
  - Report by the auditor where the company will acquire a subsidiary;
  - Report by the auditor of the company;
  - Requirements for the prospectus of a mining company (Regulations 74-80);
- Section 4 — Additional material information
  - Separate enumerated paragraphs as required to address any material information relating to the offer, not contemplated in sections 1, 2 or 3 above.
- Section 5 — Inapplicable or immaterial matters
  - A list setting out those regulation numbers and headings contemplated in the outline for Sections 1, 2 or 3 above that are not applicable in the circumstances of the offer.

Each of the individual provisions in the Regulations goes into some detail on what information must be included.

<p>In practice, a prospectus is expected to contain audited financial results for the past three years. However, there is no explicit requirement in this regard.</p> <p>The disclosure regime is a general one; there are no special rules for other types of issuers or issues such as asset-backed securities or exchange traded funds, other than a few additional requirements in Regulation 80 that apply to mining companies. These relate chiefly to disclosure of experts' opinions on a mining company's properties.</p> <p>There are no express requirements under the Companies Act mandating specific disclosure of the risks of the issuer's business in a prospectus. As part of its prospectus review process (discussed below) the CIPC has a practice of requiring the prospectus to be accompanied by a table reflecting all risks relating to the offer as well as mitigation actions. This requirement is set out in an unpublished prospectus vetting checklist. The CIPC indicated that it expects prospective investors be given this table of risks.</p> <p>Subscriptions must not be accepted from any investor unless the investor is in possession of a copy of the prospectus or is aware of its contents (section 108).</p> <p><i>JSE requirements</i></p> <p>The JSE Listing Requirements contain extensive provisions setting out the information that must be included in pre-listing statements/prospectuses (Section 6), listing particulars (Section 7), financial information (Section 8), and the circulars required for transactions such as takeover bids and those with related parties (Sections 9 and 10). Property, mineral and investment companies also have additional disclosure requirements, such as experts' reports on mineral resources or valuers' reports. There are also special disclosure elements that must be met for asset-backed securities, options, structured products, exchange-traded funds and other particular types of securities (Section 19).</p> <p>The information required to be disclosed includes information on the issuer and its capital; directors, management and advisors; securities for which application is made for listing; group activities; three years' audited financial information; material contracts; and information on the issuer's compliance with the King Report on Governance for South Africa 2009 (King III Code).<sup>29</sup> Extensive information is required. No particular format or presentation order for the information is specified.</p> <p>General requirements applicable to circulars, pre-listing statements/prospectuses and announcements are set out in Section 11 of the Listing Requirements. These include general content standards, describe the approvals required, set out what must be</p>
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<sup>29</sup> King III provides best practices principles on corporate governance for directors. King III provides guidance to all corporate entities on various governance related aspects, including ethical leadership and corporate citizenship; boards and directors; audit committees; risk governance; compliance with laws, rules, codes and standards; internal audit; and integrated reporting and disclosure. The standards in King III are not mandatory, but companies are expected to 'apply or explain' their compliance with the recommended practices. JSE listed companies must report on these matters in their Annual Integrated Reports.

delivered to shareholders and define the applicable publication requirements. There is no specific requirement referring to business risk disclosure in a prospectus or listing document, however, these matters would be captured under several of the mandated heads of information.

*Continuous disclosure requirements.*

The requirements that apply to the preparation and publication of annual and interim financial statements are discussed in Principle 18. Under the Companies Act and JSE Listing Requirements, audited annual financial statements only have to be provided to shareholders by the end of six months after the end of the relevant financial year. There are no general requirements for interim financial statements or any other routine periodic reports under the Companies Act. In practice, JSE companies are expected to produce provisional annual financial statements within three months of the year-end. These statements must be reviewed by the issuer's auditor prior to issue. In practice, most listed companies apparently issue their audited annual financial statements within the three month period.

For a discussion of the information to be provided regarding matters that require shareholder approval, see Principle 17.

**Timeliness of information in disclosure documents**

The Companies Act permits the distribution under the prospectus to continue during a four month period after the date of registration of the prospectus. Thereafter, no sales may take place unless a new prospectus is registered (section 107). Unlike for takeover bid circulars, there is no express requirement with respect to the timeliness of the information contained in the prospectus.

The JSE Listing Requirements mandate that unless otherwise provided, all information contained in a disclosure document is to be as at the issue date of the document or as near to that date as practicable (see for example, paragraph 6.9(c)).

**Advertising public offerings**

Section 98 of the Companies Act contains specific guidelines for advertising a public offering outside of a prospectus. An offer of securities may be advertised to the public, but the advertisement must contain a statement that it is not a prospectus and include information on how a copy of the prospectus may be obtained. It also must not contain any untrue statement or anything that would mislead the reader regarding any material aspect of the offering.

There are no specific provisions in the JSE Listing Requirements with respect to advertising, beyond the general principle that there should be full, equal and timely public disclosure of all material information. For listings on the JSE, the issuer's management may make presentations to market participants and/or prospective investors, or conduct meetings with prospective investors only after the listing is granted. Advisors to an offering are free to use any offering materials during the pre-

listing process, such as circulars, pre-listing statements, prospectuses and announcements. Road shows are commonly relied upon to solicit investors. There is no specific oversight of these aspects of the initial offering process at the JSE.

### **Material change disclosure**

Under Regulation 75, the directors must include in the prospectus any material changes that have occurred between the end of the financial year for which there are audited financial statements to the date of the prospectus.

A company must lodge a supplementary prospectus, if there is any material change that is related to the public offer during the distribution period. No specific time is stated for lodging the supplementary prospectus. The amendment must be published to persons known to have received the original prospectus. Should the investor not be happy about the change, the subscription may be withdrawn within 20 days after the publication (Companies Act, section 100(1) and (12)).

There is no general requirement in the Companies Act that public companies make prompt public disclosure of material changes other than during the period of an offering under a prospectus.

The JSE Listing Requirements mandate that full, equal and timely public disclosure be made to all holders of securities and the general public at large regarding the activities of an issuer that are price sensitive. Issuers are bound by this general obligation of disclosure under paragraph 3.4 throughout the period that the securities are listed.

There are extensive provisions in the Listing Requirements governing material price sensitive information that generally require issuers, without delay, to release an announcement providing details of any developments in the issuer's sphere of activity that are not public knowledge and that may, by virtue of their effects, lead to material movements of the reference price of such issuer's listed securities. The JSE also requires companies to issue, without delay, a cautionary notice if there are any developments in the issuer's sphere of activity, which may lead to material movements in the price of the issuer's securities. These are short notices flagging that there are significant matters pending, but do not contain extensive disclosure. For example, if there are merger discussions underway, but they are not yet definitive, and there is a risk that the information may have leaked, a cautionary announcement would be issued indicating that discussions are ongoing. When a binding agreement is concluded an announcement containing full details would be required to be made.

In addition, the JSE requires a company to issue a Trading Statement when there is a reasonable certainty that its financial results for the period to be reported on will differ by more than 20 percent from those of the preceding period. Transactions in company assets that are equal to 5 – 25 percent of company market capitalization must also be disclosed, including share offerings or buybacks for more than 3 percent of the market capitalization (paragraph 3.4).

	<p>These types of information must be announced in summary form over the Stock Exchange Notification System (SENS), an electronic information system operated by the JSE. Companies must also post required information on the company's website, and in some cases must publish it in the news media.</p> <p>There are also continuing obligations on listed companies to update their information that are set out in other sections of the Listing Requirements, including those with respect to financial information (Section 8), transactions (Section 9), transactions with related parties (Section 10), and circulars (Section 11).</p> <p><b>General standards and responsibility</b></p> <p>Section 29 of the Companies Act provides that financial statements must present fairly the state of affairs and business of the company and explain the transactions and financial position of the business of the company. They must not be misleading or incomplete in any material respect.</p> <p>Under section 214(1)(d) a person is guilty of an offence, if the person is a party to the preparation or dissemination of a prospectus that contains an untrue statement. An untrue statement is a statement that is misleading in the form and context in which it is made and includes omission from a prospectus or written statement of any matter that, in the context, is calculated to mislead by omission (section 95). This provision catches statements made in the prospectus or that are incorporated by reference or contained in other documents that accompany the prospectus.</p> <p>The Regulations require prospectuses to be signed by each director (Regulation 52). The Companies Act in sections 104-106 imposes liability on directors, promoters, experts and anyone who authorized the issue of the prospectus for any loss or damage caused to any purchaser under the prospectus as a result of any untrue material statement.</p> <p>Under the Listing Requirements, sponsors and Alt<sup>X</sup> Designated Advisors (DAs) are responsible for ensuring that their issuers' announcements and documents, both in principle and content, comply with the Listing Requirements. A directors' responsibility statement must be included in all prospectuses, prelisting statements and transaction circulars in which the directors collectively and individually accept full responsibility for the accuracy of the information given and certify that to the best of their knowledge and belief there are no facts that have been omitted which would make any statement false or misleading, and that all reasonable enquiries to ascertain such facts have been made and that the document contains all information required by law and the JSE Listing Requirements (paragraph 7.B.22).</p> <p>Every director of the applicant must sign the company's prospectus, pre-listing statement, or circular, and, where responsibility has been extended to or accepted by any other person (such as an auditor or expert), that other person must also sign the document (paragraph 7.B.23).</p>
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**Review**

The Companies Act established the CIPC. The CIPC has a mandate that includes:

- Registering and maintaining information concerning companies in South Africa;
- Monitoring and promoting compliance;
- Promoting the reliability of financial statements; and
- Effective enforcement of the Act (sections 186 and 187).

The CIPC is mandated to vet the prospectuses filed under the Companies Act and ensure that their content adheres to the Companies Act and other relevant legislation, such as that required for property syndication schemes under the Consumer Protection Act.

A new division within the CIPC called Corporate Disclosure Regulation and Compliance has been established to monitor compliance with disclosure requirements. A disclosure framework, disclosure process and guidelines are being established to ensure that standards and norms are adhered to. The division was set up in September 2013.

All prospectuses are vetted following an electronic checklist that includes both the disclosure requirements and a narrative explanation. A vetting committee conducts a substantive review of the prospectuses. Further, a process for periodic reporting after registration has been adopted. The company must report on the offer when it closes and again six months later. This later report confirms that the terms and conditions of the offering continue to be complied with, such as the funds have been used for the purposes stated in the prospectus.

From January 1, 2011 to December 31, 2013, 46 prospectuses were filed with the CIPC. All of these were for domestic companies. No sanctions have been imposed in connection with the prospectus process.

The CIPC is planning to issue a guidance note on the expected content of the prospectus and the prospectus process in the near future.

Information filed with the JSE with respect to applications for listing, transaction circulars etc. is subject to a detailed review process involving several analysts with relevant expertise. The documents are also subject to a final senior manager review and approval step prior to the exchange granting approval for the issue, listing or other matter.

Approved circulars and other documents are uploaded onto the JSE system and available to the public on the exchange's website. Listed firms are required to have websites and the information must also be posted on the issuer's website. Hardcopies of the documents must be available to investors at the issuer's registered office.

**Omitted information**

Under section 6(2) of the Companies Act, a person may apply for an administrative order exempting an agreement, transaction, arrangement, resolution or provision of the company's memorandum of incorporation (MOI) or rules from any requirement set out in the statute. For prospectuses, section 100(9) allows for the exclusion of otherwise required information, if its publication would be unnecessarily burdensome to the applicant, seriously detrimental to the company or against public interest, so long as users would not be unduly prejudiced by that omission. The applicant must apply to the exchange (if listed) or the CIPC (if unlisted) for this permission.

The JSE Listing Requirements provide for exceptions to the usual full, prompt disclosure obligations set out in paragraph 3.4. Under paragraph 3.10, if the directors of an issuer consider that disclosure to the public of information will or probably will prejudice the issuer's legitimate interests, the JSE may grant a dispensation from the requirement to make such information public. Further, paragraph 6.16 permits the JSE to authorize the omission of information from pre-listing statements when the JSE has received a detailed application and is satisfied that:

- The information is of minor importance and will not influence any assessment of the financial position, changes in equity, results of operations or cash flows;
- Disclosure would be contrary to the public interest and its omission is not likely to mislead investors with regard to any important/material facts and/or circumstances; or
- Disclosure would be seriously detrimental to the applicant or would constitute an invasion of the applicant's rights to privacy and its omission is not likely to mislead investors with regard to any important/material facts and/or circumstances.

Material change reports are not to be released during trading hours unless first published in accordance with the rules on SENS (paragraph 3.5). The JSE has the authority to suspend trading on the request of an issuer (paragraph 1.9) or when the trading activity in that security appears unusual (Equity Rule 6.80, Interest Rate and Currency Rule 7.40, Derivatives Rule 7.190).

Trading with knowledge of undisclosed material information is a market abuse offence under Chapter X of the FMA and subject to substantial penalties (see Principles 12 and 36). Disclosing and/or trading on confidential information and failing to disclose information required to be published are breaches of the general principles that apply under the Listing Requirements. The JSE can censure the issuer, its directors in their personal capacities, its sponsor or its Alt<sup>x</sup> DA, and executives of the sponsor or DA for any breach of the requirements (Listing Requirements, Sections 1 and 3). In addition, the JSE can also refer matters to the FSB where there may have been insider trading, market abuse, etc.

	<p><b>Cross-border offerings</b></p> <p>Cross-border offerings are not common in the jurisdiction.</p> <p>There have been no prospectuses filed with the CIPC by foreign companies in the past three years. Only 45 of the listings on the JSE are secondary listings (slightly over 10 percent). Many of these companies have their primary listing on major international exchanges such as NASDAQ, Euronext, or the exchanges in London, Toronto or Australia.</p> <p>Under the Companies Act, foreign issuers would have to comply with all the usual prospectus requirements and file their MOI and details of their directors at least 90 days before the offering (section 99).</p> <p>An issuer seeking a primary listing on the JSE must comply with all the initial and on-going requirements set out in the JSE Listing Requirements, regardless of where it is located. Issuers seeking a secondary listing on the JSE must comply with the entry criteria that apply to all applicants for listing. However, provided that its primary listing is on an exchange that is a member of the World Federation of Exchanges, the JSE usually relies on the disclosure etc. required by the exchange on which the issuer has its primary listing. In addition, the issuer must comply with the JSE's rules on immediate public disclosure of material changes.</p> <p>There have been circumstances where the JSE has required that both its initial and continuing requirements be complied with by a company with a secondary listing. These conditions would be imposed when the JSE is of the view that its requirements are much more onerous than those of the primary exchange.</p>
Assessment	Partly Implemented
Comments	<p>The initial disclosure requirements for an offer of securities to the public to be listed on the JSE are satisfactory, as are most of the continuous disclosure requirements thereafter. There are significant gaps in both the initial and continuous disclosure requirements applicable to public companies that are not listed on the exchange. Unlisted entities (other than companies and CIS) offering their securities to the public do not appear to be required to make any disclosure, either initially or thereafter. This gap is compounded by the fact that an issuer can sell its securities directly to a member of the public without going through a licensed market intermediary or being licensed itself for such activity.</p> <p>Under the Companies Act, the initial prospectus disclosure requirements do not:</p> <ul style="list-style-type: none"> <li>• Contain specific information on the financial information that must be provided and there is no requirement that the information contained in the prospectus be timely; and</li> <li>• Require the prospectus to contain detailed information on the risks of the</li> </ul>

	<p>issuer and the securities.</p> <p>The relevant regulations should be supplemented to include these provisions. In the meantime, the CIPC should issue guidance on these topics.</p> <p>There are very few continuous disclosure requirements in the Companies Act, beyond an obligation to prepare annual financial statements within six months of the company's year-end. This is very slow. There is no requirement for interim statements and there is no requirement for prompt public disclosure of material changes after the prospectus distribution period is over. There is a requirement for a company to file a notice of change of auditor to the CIPC, but only within 10 days after the change. This notice does not need to be communicated to the shareholders.</p> <p>All entities, regardless of their legal form of organization, that have issued securities to the public should be subject to both initial and continuous disclosure requirements, regardless of whether they are listed on an exchange. This should include annual audited and interim financial statements. All public companies should publish and file their annual audited financial statements promptly after the year end. In most major jurisdictions, the deadline for such statements is a maximum of 120 days, with many moving to shorter periods. Consideration should be given to amending the Companies Act provisions to shorten the deadline accordingly. The Companies Act should also be amended to require publication of interim financial statements at least semi-annually, within a reasonable period after the period end.</p> <p>All public companies should make prompt public disclosure of material changes. A change in auditor should always be considered to be a material change, giving rise to an immediate obligation for all public companies to inform the relevant authorities and make prompt public disclosure. The Companies Act should be amended to include both of these requirements.</p> <p>Under the JSE Rules, the stated reporting deadline for annual audited financial statements is six months, which is very slow by international standards. However, the listed issuer is expected to produce attested financial statements within three months and the practice is to issue the audited statements within that period. It would be better if this requirement were made mandatory. The 90-day deadline for semi-annual statements is also long by international standards.</p> <p>The JSE is encouraged to make the de facto 90-day deadline for audited financial statements a firm requirement. Consideration should be given to whether the Alt<sup>x</sup> issuers should adhere to the same time frame or be given somewhat longer. Consideration should also be given to shortening the reporting period for interim statements of JSE companies; 60 days or less is a more common period for main listing on major exchanges.</p>
<b>Principle 17.</b>	Holders of securities in a company should be treated in a fair and equitable manner.

Description	<p><b>Equality of Treatment and Disclosure</b></p> <p><i>Companies Act</i></p> <p>Under section 37 of the Companies Act, all the shares of any particular class of a company must have preferences, rights, limitations and other terms that are identical to those of other shares of the same class. Each share has a voting right attached to it unless specifically limited by the Companies Act or the company's MOI. There must be at least one class of shares designated as voting shares. In all cases, the shareholder has a right to vote on any proposal to amend the rights attached to the shares held.</p> <p>Section 66(4) permits the direct appointment of directors by particular persons, if this is set out in the company's MOI; however, for-profit companies other than state-owned ones must provide for the election by shareholders of at least 50 percent of the directors and 50 percent of any alternate directors. The election of directors takes place at the annual meeting of shareholders.</p> <p>Under the Companies Act, transactions such as a sale of the business or a substantial part of the business or assets of the company or an amalgamation with another company are subject to a disclosure process (sections 112 and 113) and require the approval by special resolution of shareholders (i.e., 75 percent approval) (section 115).</p> <p>Under section 62 of the Companies Act, shareholders of public companies must be given at least 15 days notice of a meeting of shareholders and provided with:</p> <ul style="list-style-type: none"> <li>• The date, time and place for the meeting, and the record date for the meeting;</li> <li>• The general purpose of the meeting, and any specific purpose that might apply;</li> <li>• A copy of any proposed resolution of which the company has received notice, and which is to be considered at the meeting, and a notice of the percentage of voting rights that will be required for that resolution to be adopted;</li> <li>• Information on the financial statements of the company (if an annual meeting); and</li> <li>• A statement on the shareholder's rights to attend the meeting or appoint a proxy.</li> </ul> <p>This information must be sent to shareholders by mail and be posted on the company's website. The Regulations do not impose more detailed information requirements on ordinary shareholder meetings.</p> <p>Under section 58 of the Companies Act, a shareholder has the right to appoint someone as proxy to attend shareholder meetings and vote on behalf of the shareholder. The company is not obliged to provide a form of proxy with the shareholder meeting materials, but if it does so, that proxy form must be sent to all shareholders entitled to vote and must contain a summary of the statutory provisions</p>
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	<p>governing proxies.</p> <p>Under section 51, if the share has been transferred and the company receives satisfactory evidence of the transfer, the company must enter the transfer of any certificated securities in its register.</p> <p>Dividends must be declared by the board of directors of a company and the record date for payment published to shareholders (Companies Act, section 46).</p> <p>There are rules set out in Chapter 5 of the Companies Act and the Regulations that govern fundamental transactions, takeovers and offers. These provisions contain detailed information and timing requirements and specify when shareholder approvals are required. The relevant rules of the JSE relate to JSE prior approvals of announcements, notice provisions and requirements that information must be filed with the JSE and the TRP. All holders of the same class of securities must be treated equally. See the discussion below.</p> <p>Directors are subject to extensive legal duties and liabilities under the Companies Act (section 77). They are subject to statutory fiduciary duties and must act in the best interests of the company.</p> <p>There are provisions in Chapter 6 of the Companies Act governing business rescue arrangements and compromises with creditors. Under section 137, during business rescue proceedings, an alteration in the classification or status of any issued securities of a company, other than by way of a transfer of securities in the ordinary course of business, is invalid unless directed by the court or as contemplated in an approved business rescue plan. Shareholders of the same class are treated alike on a business rescue, liquidation or insolvency of a company under the Companies Act.</p> <p><i>JSE requirements</i></p> <p>Under paragraphs 3.27 to 3.33 of the JSE Listing Requirements, an issuer must ensure that all holders of any class of its securities that are in the same position receive fair and equal treatment. An issuer may not issue any securities with voting rights differing from other securities of the same class. Paragraph 3.29 requires securities in each class to rank equally in respect of all rights; they must be identical and have the same nominal value, paid up amount per share, right to unrestricted transfer of the shares, right to attend and vote at general/annual general meetings and right to dividends.</p> <p>See also the JSE Listing Requirements in paragraphs 1.14 to 1.16 and Schedule 10.15 to 10.17, that set out specific requirements for voting in related party transactions, repurchase of securities and the issue of shares for cash. Amendments to share capital and the rights attached to any class of listed shares are subject to the JSE and shareholder approval. Public companies that issue new stock must provide existing shareholders with a pre-emptive rights offering, unless 75 percent of voting shareholders approve the issue.</p> <p>Section 9 of the Listing Requirements governs significant transactions proposed by the</p>
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JSE listed companies. The applicable public notice/circular requirements vary based on the nature and size of the transaction. Larger transactions require shareholder approval. Fundamental changes to the company generally require extensive information to be provided to shareholders via a circular containing the information required by the JSE. As noted under Principle 16 all of these documents require the approval of the JSE prior to issue.

A proxy form together with the notice convening a meeting of holders of JSE listed voting securities must be sent to each person entitled to vote at such meeting (paragraph 3.52). Under paragraph 3.49, circulars and pre-listing statements (including proxies) must be sent to all beneficial shareholders, including specific instructions for both dematerialized and certificated shareholders as to submission of their voting instructions. Paragraph 11.1 sets out detailed requirements for the contents of all circulars and pre-listing statements, including the general requirement that if voting or other action is required the document must:

- Contain all information necessary to allow the holders of the securities to make a properly informed decision; and
- Contain a heading drawing attention to the importance of the document and advising holders of securities that are in any doubt as to what action to take, to consult appropriate independent advisers.

Under the JSE requirements, all certifications of paper share transfers must be completed within 24 hours of lodgment and, in the dematerialized environment, be approved as Strate eligible in terms of the Central Securities Depository Rules (paragraph 3.51).

### **Takeover transactions and other changes in control**

Takeovers and mergers are regulated by the TRP under Chapter 5 of the Companies Act and Chapter 5 of the Regulations made under the Companies Act (Takeover Regulations).

The takeover regime applies to all “affected transactions” regarding a “regulated company”, which is a public or state-owned company or a private company where 10 percent or more of its issued securities have been transferred other than among related persons within 24 months prior to the date of the transaction (Companies Act, sections 117 and 118(1))

“Affected transactions” are defined in section 117 of the Companies Act and include:

- A transaction or series of transactions disposing of all or the greater part of the assets of a regulated company, under section 112;
- An amalgamation or merger, as contemplated in section 113, if it involves at least one regulated company;
- A scheme of arrangement between a regulated company and its shareholders,

	<p>as contemplated in section 114;</p> <ul style="list-style-type: none"> <li>• The acquisition of, or announced intention to acquire, a beneficial interest in any voting securities of a regulated company under section 122(1);</li> <li>• The announced intention to acquire a beneficial interest in the remaining voting securities of a regulated company not already held by a person or persons acting in concert;</li> <li>• A mandatory offer under section 123; and</li> <li>• A compulsory acquisition under section 124.</li> </ul> <p>Under section 119 of the Companies Act, the TRP must regulate any affected transaction or offer in accordance with the law and the regulations in order to:</p> <ul style="list-style-type: none"> <li>• Ensure the integrity of the marketplace and fairness to the holders of the securities of regulated companies;</li> <li>• Ensure the provision of: <ul style="list-style-type: none"> <li>• Necessary information to holders of securities of regulated companies, to the extent required to facilitate the making of fair and informed decisions; and</li> <li>• Adequate time for regulated companies and holders of their securities to obtain and provide advice with respect to offers; and</li> </ul> </li> <li>• Prevent actions by a regulated company designed to impede, frustrate, or defeat an offer, or the making of fair and informed decisions by the holders of that company's securities.</li> </ul> <p>The TRP's tasks are to be carried out in a manner that ensures:</p> <ul style="list-style-type: none"> <li>• That no person may enter into an affected transaction unless that person is ready, able and willing to implement that transaction;</li> <li>• That all holders of: <ul style="list-style-type: none"> <li>• Any particular class of voting securities of a target regulated company are afforded equivalent treatment;</li> <li>• Voting securities of a target regulated company are afforded equitable treatment, having regard to the circumstances;</li> </ul> </li> <li>• That no relevant information is withheld from the holders of relevant securities;</li> <li>• That all holders of relevant securities: <ul style="list-style-type: none"> <li>• Receive the same information from a bidder, potential bidder, or target regulated company during the course of an affected transaction, or when an affected transaction is contemplated; and</li> <li>• Are provided sufficient information, and permitted sufficient time, to</li> </ul> </li> </ul>
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enable them to reach a properly informed decision.

*Information*

The bid must be notified in writing to the target's board or its advisers (Takeover Regulation 99). There is no requirement for prior notification to the TRP. The TRP must be notified when a cautionary announcement or a firm intention announcement is made regarding an affected transaction (Regulation 99), although it encourages the parties to consult with it before then.

All documents relating to an affected transaction must be approved by the TRP before they are posted or published (Regulation 117).

The target's board is entitled to be reasonably satisfied that the bidder is, or will be, in a position to implement the offer in full. The TRP must also be satisfied that the bidder has sufficient resources before approving the offer document (Regulation 99).

A cautionary announcement is a brief statement published in the press and on SENS. Its aim is to preserve the integrity of trading in a company's shares on the JSE, both before and during negotiations concerning an offer. It usually only states that either:

- Talks are taking place and that a potential bidder is considering making an offer; or
- An announcement is pending which could have a material effect on the price of the bidder's or the target's shares (Regulation 100).

A company must make a cautionary announcement, if it acquires knowledge of any material price sensitive information and the necessary degree of confidentiality of the information cannot be maintained or the company suspects that confidentiality has been breached.

An announcement of a firm intention to make an offer must be made when the target's board has been notified, in writing, of a firm intention to make an offer from a serious source or where a mandatory offer must be made. The target company is responsible for making the announcement. It is published in the press and on SENS and must contain:

- The terms of the offer;
- The identity of the bidder;
- The details of any existing holders of shares in the target;
- All material conditions to which the offer is subject; and.
- The details of any arrangements that exist between the bidder and the target or any concert party of the bidder or the target (Regulation 101).

Following the announcement, the bidder must proceed with the offer in 20 business days, unless the posting of the offer is subject to a condition that has not been fulfilled (for example, approval of the bid by the bidder's shareholders or the competition

	<p>authorities).</p> <p>The bidder must send the offer document to the target's shareholders. This document must include:</p> <ul style="list-style-type: none"> <li>• The reasons for the offer, and the intentions of the bidder in relation to the continuation of the business and the continuation in office of the target's directors;</li> <li>• Financial and other information on the target and the bidder;</li> <li>• The bidder's holdings in the target;</li> <li>• Whether directors' remuneration will be affected by the acquisition of the target or by any other associated transaction;</li> <li>• The terms and mechanics of the takeover offer;</li> <li>• Arrangements, undertakings or agreements between the bidder and the target in relation to the takeover offer; and.</li> <li>• A fair and reasonable opinion from an independent expert (Regulation 106(4)).</li> </ul> <p>In the 20 business days following the posting of the offer document, the target's board must circulate its views on the takeover offer (and make any alternative offers known) to the target's shareholders. The target's response circular must set out:</p> <ul style="list-style-type: none"> <li>• The board's comments on the statements in the offer document in relation to the bidder's intentions for the target and its directors;</li> <li>• The holding of any shares in the bidder by the target;</li> <li>• Whether the target's directors intend to accept or reject the offer in respect of their own holdings;</li> <li>• Material particulars of the service contracts of the directors; and.</li> <li>• Disclosures of any arrangements, undertakings or agreements between the bidder and the target (Regulation 106(7)).</li> </ul> <p>The offer document and the target's board document must satisfy the highest standards of accuracy and the information given must be adequately and fairly presented.</p> <p>If the offer is revised, an updated offer document must be sent to the target's shareholders. This document must contain details of any material changes in information previously published by, or on behalf of, the parties during the offer period and the information required by the Companies Act (Regulation 104).</p> <p><i>Timetable</i></p> <p>The timetable for takeover offers is set out in Regulation 102:</p> <ul style="list-style-type: none"> <li>• The timetable begins when the firm intention announcement is published.</li> </ul>
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- After publication of the firm intention announcement, the bidder has 20 business days to post the offer document to the target's shareholders.
- The offer must initially be open for acceptance for at least 30 business days after the offer document is posted.
- The target's independent board must advise its shareholders of its views of the offer within 20 business days of the posting of the offer document by way of a response circular.
- The offer must be declared unconditional (that is, that all the necessary acceptances have been received) within 45 days from the posting of the offer document, or the offer will lapse.

Once the offer has been declared unconditional, the bidder must announce that fact within one business day and the offer must remain open for a further ten business days after that announcement.

Consideration for the offer must be settled within six business days of the offer becoming or being declared unconditional, or the offer being accepted, whichever is the later.

An offer may be extended by an announcement made prior to the initial closing date provided that the right to do so has been specifically reserved in the offer document.

If the consideration for an offer is revised (by increasing the original announced consideration or providing an alternate consideration), it must remain open for 15 business days following the date on which the revised consideration is announced. Shareholders who have accepted the original consideration are entitled to revise their initial acceptance and elect to receive the revised offer.

#### *Mandatory offers*

A mandatory offer must be made for the rest of the target's shares, if a bidder's holding (or its combined holding with any concert party) increases to 35 percent or more of the voting rights of the target (Companies Act, section 123).

Mandatory offers must be made at the highest price paid for the relevant shares in the six months preceding the offer (Regulation 111(2)).

A transaction is exempt from the requirement to make a mandatory offer, if the holders of a majority of the independent shares of the target (in other words, excluding shares held by the bidder and its concert parties) have agreed to waive the mandatory offer (Regulation 86(4)).

#### *Consideration*

A bidder may offer cash, shares or other securities, or a mixture of any of these, as consideration for a bid. However, where the bidder, or its concert parties, acquired shares in the target carrying 5 percent or more of the voting rights during the six

	<p>month period before the offer is made and paid cash for those securities, the offer must be in cash (or accompanied by a cash alternative) at not less than the highest price paid by the bidder in that six-month period (Regulation 111(2)).</p> <p>If any bidder or person acting in concert with a bidder acquires any shares subject of the bid after the firm announcement at a price higher than the bid price, the offer must be amended to reflect this higher price (Regulation 111(6)).</p> <p>No person may be given more favorable terms than those offered to all affected shareholders.</p> <p>Comparable offers are required to be made to all classes of issued securities that have voting rights or may have voting rights in the future, such as options (Regulation 87(2)).</p> <p><i>Squeeze-out transactions</i></p> <p>Where a takeover offer is made and 90 percent of a class of the target's shareholders accept the offer, the bidder can compulsorily purchase the shares of the non-accepting shareholders in that class (Companies Act, section 124). A court may in certain circumstances authorize such a squeeze-out despite the fact that less than 90 percent of shareholders of a class has accepted the offer.</p> <p>A non-accepting shareholder can apply to court within 30 business days of the posting of the compulsory acquisition notice for an order to prohibit it or make it subject to conditions.</p> <p><b>Disclosure of significant shareholdings</b></p> <p>A person who acquires a beneficial interest in shares of five percent, or any multiple of five percent (i.e., five, 10, 15), of a particular class of shares issued by a regulated company must notify the company within three business days of such acquisition. Similarly, a person must notify the company within three business days, if a disposal of securities results in that person dropping below a threshold that is a multiple of five percent. A regulated company must then notify the TRP and shareholders of such disclosures unless the transaction was a disposition of less than 1 percent of the class (Companies Act, section 122).</p> <p>Under the Listing Requirements, an issuer must publish the information provided in a disclosure notice within 48 hours on SENS. The disclosure requirements apply irrespective of whether the acquisition or disposal was made directly, indirectly, individually or in concert with any other person. Options and other interests in securities must be taken into account in calculating whether an ownership or reporting threshold has been reached.</p> <p>A regulated company must disclose shareholdings of more than five percent in its annual financial statements and its shareholders' circulars (Companies Act, section 56(7) and Listing Requirements, paragraph 8.63). Under the Listing Requirements it must also include the names and securities positions of any person holding more than</p>
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five percent of any class of securities of a listed issuer in its listing particulars.

In addition, a nominee shareholder (a registered holder of shares who holds on behalf of the beneficial holder) of a regulated company must disclose to the company the identity of the beneficial holder within five business days after the end of every month during which a change has occurred (Companies Act, section 56(4)). The company can also compel a nominee shareholder to disclose the identity of the beneficial holder at any time (section 56(5)).

#### **Disclosure of shareholdings of directors and senior management**

A company that is required to have its financial statements audited (all public companies) must include disclosure in those financial statements of the number and class of any securities of the company issued to any director or person holding a prescribed office or any related person (Companies Act, section 30(4)). In the context of a bid, Regulation 106 requires the bid circulars to disclose the shareholdings of directors:

- Of the target company in both the target and bidder companies; and
- Of the bidder company in both the bidder and target companies.

Under paragraphs 3.63 – 3.74 of the Listing Requirements, all transactions in securities by directors of listed companies must be disclosed to the issuer. Details of all transactions (including off-market transactions) in securities relating to the issuer by or on behalf of: a director and company secretary (held beneficially, whether directly or indirectly) of the issuer; a director and company secretary (held beneficially, whether directly or indirectly) of a major subsidiary company of the issuer; or any associate of them must be reported. Directors are required to disclose transactions without delay and, in any event, by no later than 24 hours after dealing. The issuer must in turn publically announce such information on SENS without delay and, in any event, by no later than 24 hours after receipt of such information from the director concerned (paragraph 3.63). The provisions contain a very wide list of transactions and securities that must be reported.

#### **Application to parties acting in concert**

If one or more persons are acting in concert, as that term is defined in section 117(b) of the Companies Act and Regulation 84, with the bidder, their holdings are aggregated for the purposes of any calculation or reporting required by the regime governing fundamental transactions and takeovers in Chapter 5.

The Listing Requirements in paragraph 3.63 also require information on the securities positions of directors and their associates to be included in listing particulars, annual financial statements and circulars. Associate is a defined term and includes the person's immediate family, any trustee of a trust of which the person or his/her immediate family is a beneficiary and a company in which the person and/or his associates have at least a 35 percent direct or indirect ownership interest.

**Enforcement**

The Companies Act contains enforcement provisions in Chapter 7. Investigations may be performed by the CIPC or TRP under section 168. They may issue compliance orders under section 171 unless the alleged contravention could otherwise be addressed under the Companies Act by an application to a court or to the Companies Tribunal. The CIPC has issued approximately 160 compliance notices, often in response to irregularity notices filed by accountants or auditors as required by the law. Market participants indicated there is a substantial backlog of matters waiting for court action.

The DTI, that was directly responsible for enforcement of companies legislation before the establishment of the CIPC, previously submitted some matters to the criminal authorities. Due to the complexity of enforcing the Companies Act by the police and the NPA, the matters submitted either did not lead to charges or the charges were withdrawn before trial. The CIPC has referred three cases for criminal enforcement under the new Companies Act. These matters are ongoing.

The JSE has the power to ensure that issuers comply with its Listing Requirements. As noted above, circulars and other information provided by issuers must be approved by the exchange prior to distribution to shareholders. Compliance with the Listing Requirements is also enforced on an on-going basis and the JSE Issuer Regulation Department devotes significant resources to this activity. Five of thirty-five employees in the department are investigators.

Under paragraphs 1.20 to 1.22 of the Listing Requirements, failure to comply with the JSE requirements may result in sanctions such as a public censure or fine. Using the disciplinary processes set out in the Listing Requirements, the JSE has imposed sanctions that range from private censures to suspension of listing and permanent removal from listing. Private censures are often imposed for minor technical breaches of the rules, such as filing documents a day late. To provide guidance to the market, the exchange publishes periodically no-name summaries of these actions.

The JSE has also established the Financial Reporting Investigation Panel (FRIP) to monitor compliance by the companies listed on its exchange with the IFRS. (See the discussion in Principle 18.) Where breaches of the accounting rules are suspected or there may have been a problem with the audit, the FRIP refers the matters to the relevant body, such as IRBA.

There is evidence that these powers have been exercised in practice. The JSE reports annually to the FSB with information on actions taken, including public censures and withdrawals of listing. These matters are also published on the JSE website. For example, in the 2013 report, two issuers were subject to public sanctions for failure to meet disclosure obligations and three companies were removed from listing for failure to meet the requirements for continued listing. Several other issuers were censured for late filing of financial statements.

	<p><b>Cross-border issuers</b></p> <p>Cross-border offerings are not significant in the jurisdiction. See the discussion under Principle 16 on the requirements that would apply to these transactions.</p>
Assessment	Fully Implemented
Comments	The 15-day notice period for shareholder meetings may pose some practical challenges for foreign shareholders, unless the issuer has implemented electronic voting facilities. Otherwise, it may be difficult to receive the materials, make an informed decision, execute the proxy and get that back to the issuer in advance of the meeting date.
<b>Principle 18.</b>	Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.
Description	<p>All public companies in South Africa, whether listed or unlisted, are required to prepare their financial statements in accordance with the IFRS as issued by the IASB (Companies Act, sections 27-30, and Regulations 26-30; JSE Listing Requirements, paragraph 8.62). Some small, unlisted public companies may use IFRS for Small and Medium-Sized Entities (SMEs) under Regulation 27. All issuers with securities listed on the JSE, regardless of the legal form of the issuer, must prepare their financial statements in accordance with the IFRS. South Africa was one of the first countries to permit the use of IFRS (in 1999) and in 2004 adopted the IFRS. The FSB is a member of the Monitoring Board of the IFRS Foundation.</p> <p>Audited financial statements are required to be included in prospectuses under the Companies Act (section 100 and Chapter 4 of the Regulations). There are no specific references to inclusion of financial statement information in the detailed provisions that apply to prospectuses. Paragraph 8.4 of the Listing Requirements mandates that prospectuses, pre-listing statements and transaction circulars contain three years of audited financial information.</p> <p>Audited financial statements or annual reports that contain/are accompanied by audited annual financial statements must be prepared by all public companies, listed or unlisted (Companies Act, section 30, JSE Listing Requirements, paragraph 3.19). Under paragraph 3.19 of the Listing Requirements, every issuer must, within six months after the end of each financial year and at least 15 business days before the date of the annual general meeting, distribute these audited statements to all holders of securities and submit them to the JSE. Section 30 of the Companies Act imposes similar requirements on unlisted public companies. The financial statements normally are distributed to shareholders with the annual meeting notice and other materials. As noted above, JSE firms are expected to issue provisional annual financial statements within three months of the year-end and these statements must be reviewed by the issuer's auditor prior to issue. The practice is to issue audited financial statements</p>

within the three month period.

Under the IFRS, both audited and interim statements are required to contain a balance sheet, statement of results of operations, statement of cash flow, and a discussion of changes in ownership equity, along with notes to these statements. Accounting statements prepared using the IFRS are required to be comprehensive, designed to meet the needs of investors, reflect consistent application of accounting standards and be comparable across accounting periods.

Unaudited interim financial statements for listed companies are required to be prepared in accordance with the IFRS requirements on interim reporting - IAS 34, the financial reporting guides issued by the Accounting Practices Committee of the South African Institute of Chartered Accountants (SAICA) and financial reporting pronouncements (FRP) issued by the Financial Reporting Standards Council (FRSC) established under the Companies Act. They must also comply with the requirements of the Companies Act that apply to financial statements generally. A statement confirming that the interim statements have been so prepared must be included in the report (JSE Listing Requirements, paragraph 8.57). Interim reports must be published and distributed to shareholders after the end of the first six-month period of a financial year, by no later than three months after that date. For issuers that prepare quarterly reports, these must be published as soon as possible after the end of each quarter (paragraph 3.15).

There are some references to interim financial information in the Companies legislation under the secondary offering prospectus requirements in section 101(6)(c) of the Act and the bid circular requirements under Regulation 106(7)(c). There is no general obligation for public companies to issue interim statements under the Companies Act.

### **Oversight**

The Companies Act established the FRSC to advise the Minister of Trade and Industry (MTI) on matters relating to financial reporting standards. The FRSC's responsibilities include:

- Receiving and considering any relevant information from the CIPC and other sources relating to the reliability of, and compliance with, financial reporting standards;
- Advising the MTI on matters relating to financial reporting standards, including the making of regulations that establish financial reporting standards and requirements for the form and content of the summaries of financial statements; and
- Adapting international reporting standards for local circumstances, including development of authoritative interpretations for specific issues that only occur in South Africa (section 204).

The regulations prescribe the use of either the IFRS or the IFRS for SMEs with respect

to all public companies. Therefore, the FRSC has no role in setting applicable accounting standards for these entities. The FRSC does, however, have the power to issue FRPs, which take into account South African circumstances and issues not specifically addressed by the IFRS, such as accounting for Black Economic Empowerment transactions and the interaction of IAS 19: Employee Benefits, and the South African pension fund environment. The FRSC may also issue FRPs where divergent practices have arisen. These FRPs may not contradict or weaken the IFRS or the IFRS for SMEs. The FRSC reviews any newly issued IAS or interpretations and assesses their local impact with a view to determining whether local interpretations in the form of FRPs are required. Also, the FRSC may consider issuing interpretations where there appears to be a need for additional clarity.

The FRSC has a role in participating and influencing the IASB in its accounting standard setting process and participating in standard-setting initiatives. In fulfilling these roles, the FRSC draws on the expertise and technical resources of South African accountancy bodies, regulators, and business and investment professionals.

The FRSC was formed in October 2011 and its members were appointed by the MTI to serve three year terms; they may be reappointed. The appointed members of the FRSC include auditors; preparers of financial statements for both public and private companies; security holders or creditors who rely on financial statements; company law experts; and representatives from the FSB, SARB, and JSE. There is also a small professional secretariat charged with supporting the functions of the FRSC.

The rules of procedure of the FRSC are published on the DTI website. These rules set out information about the establishment of the FRSC, its due process policy, and its administrative policies and procedures. Information on the activities of the FRSC is also available online, including its annual activity plans, minutes, agenda and other reports.

FRPs and other publications must be developed following an open process that involves publication for comment and input from accountants, auditors, preparers, regulators, academics, legal authorities and users of financial statements. Due process is viewed as necessary to ensure the quality and independence of the FRSC's recommendations and its continued relevance.

#### *Compliance reviews*

The Companies Act requires that any financial statements prepared by a company should not be false, misleading or incomplete in any material respect (section 29(2)). The statute also criminalizes the intentional preparation, approval, dissemination, or publication of materially false or misleading statements (section 214) and requires the CIPC to enforce and report on compliance with financial reporting requirements. The Regulations impose an obligation on auditors and other independent reviewers to submit notices of reportable irregularities to the CIPC (section 29). If the irregularity falls within its scope of authority, the CIPC may choose to conduct an investigation; otherwise it is statutorily obliged to refer the report to the appropriate regulator.

	<p>However, the statute does not provide a safe harbor for any auditor filing these reports; they may still be subject to law suits from clients for the breach of their duties of confidentiality.</p> <p>The CIPC is required to promote the reliability of financial statements by monitoring patterns of compliance with, and contraventions of, financial reporting standards and making recommendations to the FRSC for amendments to the financial reporting standards.</p> <p>To fulfill its mandate to monitor compliance with the IFRS, in April 2014 the CIPC established a system to select and review a sample of financial accountability supplements, audited annual financial statements, and independently reviewed annual financial statements that have been filed under the Companies Act. The program reviews five financial statements every month from high risk public and private companies that have a public interest score above 350. This forms part of the CIPC's operational plan for 2013/14 and 2014/15. There are over 3000 public companies in South Africa, not including those listed on the JSE.</p> <p>The reviews of financial statements address both general compliance with the Companies Act, the IFRS and the King III Code and an evaluation of the solvency and liquidity of the companies. The latter evaluation uses simple balance sheet formulae such as the ratio of current assets to current liabilities and the ratio of total assets to total liabilities.</p> <p>The CIPC's longer term intention is to adopt a process analogous to that used by the JSE FRIP (see below) and engage with one or more universities to make use of their expertise to expand the review process.</p> <p>The JSE and SAICA in 2002 formed the GAAP Monitoring Panel (now called FRIP) to review financial statements of listed companies. The joint initiative was established to fill the gap in the previous Companies Act where there was no requirement to review financial statements for compliance with stipulated accounting standards.</p> <p>In April 2011, the JSE commenced a process of proactively reviewing annual financial statements (AFS) for compliance with the IFRS. The objective of the JSE's review process is to contribute to the production of quality financial reporting of entities listed on its market.</p> <p>In any year approximately 80 companies are reviewed. Selections are made using both a random selection process and one where certain AFS are targeted based on pre-determined risk areas that change from year to year. The selection process aims to review AFS across all sectors and markets and to cover issuers of all sizes. The focus is on aspects of financial reporting that are potentially price sensitive or could affect investors' understanding of the issuer's business.</p> <p>Every listed company's annual report and annual financial statements is subject to an intensive accounting review by the University of Johannesburg at least once every five</p>
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years. The partnership with the university gives the JSE effective access to 21 additional expert reviewers.

The feedback is then researched and considered by the JSE Listing Division. Issuers are then contacted in writing, and where necessary, are required to respond to areas of concern.

Under this review process, only certain cases where the JSE requires detailed technical advice are referred to the FRIP, following a process set out in the FRIP Charter (available on the SAICA website). A review panel of five members selected from the 16 FRIP members reviews each case referred. The results of the review are then reported to the JSE.

The JSE is able, in its sole discretion, to instruct the management of a non-compliant company to publish or reissue any information it deems appropriate or to censure the issuer (paragraph 8.65). Where errors and omissions are identified, the matter may be referred to IRBA and/or SAICA to take the necessary disciplinary action against the auditor or accountant involved (paragraph 8.66). In addition, the FSB can take separate action against the issuer under the FMA for the publication of false or misleading information.

The JSE publishes an annual report regarding its monitoring program, which includes a description of the process and its outcomes. The statistics from its first three years of activity are set out below. As of the end of 2013, the JSE had reviewed the AFS of 216 issuers, with 10 repeat reviews.

#### JSE Annual Financial Statements Reviews

	2011	2012	2013
Total AFS reviewed	56	82	78
Cases closed immediately (no issues)	16	14	19
Letters of inquiry sent	40	68	59
Cases brought forward from previous year		11	15
Cases pending	(11)	(15)	(9)
Cases completed during period	45	78	84

Source: JSE, Report Back on Pro-Active Monitoring of Financial Statements in 2013.

#### Outcomes of JSE AFS Reviews

	2011	2012	2013
Material misstatements – immediate restatement and public announcement made	2	7	3
Misstatements – must be corrected with next published results	2	2	8
Non-material compliance issues – must be corrected in next published results	10	10	7
Total of AFS with required corrections	14	19	18
Smaller disclosure issues that will be corrected in future	15	28	33
Total cases with corrections	29	47	51

	<p>Other AFS without issues or only potential areas of improvement identified* 16 31 33</p> <p>Total cases closed 45 78 84</p> <hr/> <p>Source: JSE, Report Back on Pro-Active Monitoring of Financial Statements in 2013. * includes files closed immediately.</p> <p>The IRBA Inspections Department also performs financial statements reviews as part of the inspection process. Although financial statement reviews are performed on all inspections, the IFRS specific reviews are also performed on a sample basis, depending on the available capacity of the inspectors. The criteria used for selecting IFRS reviews are based on the risk factors identified (as discussed in Principle 19) regarding the firms, partners, industry, previous results, ratios, market capital, public interest score, etc.</p> <p><b>Cross-border</b></p> <p>For entities with a secondary listing on the JSE, South Africa recognizes IFRS, U.S. GAAP, IFRS as adopted by the European Union, UK GAAP, Australian GAAP and Canadian GAAP (Paragraph 8.13 of the JSE Listing Requirements). Of the 386 entities listed on the JSE, about 45 entities have a secondary listing.</p> <p>Issuers with secondary listings usually are required to comply only with the listing requirements of the exchange where they have their primary listing, except if otherwise specifically stated in the Listing Requirements.</p>
Assessment	Fully Implemented
Comments	As noted under Principle 16, there are gaps in the requirements for interim financial statements and the deadlines for releasing financial statements are slow. The downgrade for these gaps is reflected in the rating for Principle 16 and not here.
<b>Principles for Auditors, Credit Ratings Agencies, and Other Information Service Providers</b>	
<b>Principle 19.</b>	Auditors should be subject to adequate levels of oversight.
Description	<p>The Auditing Profession Act, 2005 (APA) established IRBA to regulate the auditing profession. The APA provides that IRBA's responsibilities include registration, inspection, and discipline of auditors, as well as the accreditation of professional bodies. IRBA replaced the Public Accountants and Auditors Board (PAAB), which was a self-regulatory body for the profession. IRBA also has responsibility for setting auditing standards and standards of professional competence, ethics, and conduct for registered auditors (RAs).</p> <p>IRBA is a member of the International Forum of Independent Audit Regulators (IFIAR).</p> <p>The ISA issued in 2009 by the IAASB, which is the independent standard-setting body of the International Federation of Accountants (IFAC), have been officially adopted for</p>

use in South Africa. Upon its establishment, IRBA confirmed the adoption of the ISA and other pronouncements as issued by the IAASB to be applied by RAs in South Africa. The continuing adoption and prescription of the IAASB standards is made legally effective by IRBA publishing notices in the government Gazette.

IRBA also has the mandate to develop and issue its own authoritative and non-authoritative pronouncements with regard to auditing and other professional standards. The authoritative pronouncements issued by IRBA are to be consistent with the principles of the international standards, but may provide implementation requirements or application material on a particular subject.

IRBA's Competency Framework and Training Model sets out minimum academic credentials, professional training and other competencies that must be met for individuals to qualify for registration as an RA. An applicant must be a professional accountant, qualified through a professional body recognized by IRBA, and, starting this year, complete an audit development program that entails at least two years of specialized work experience. The Competency Framework also imposes minimum continuing professional education requirements.

There are approximately 4,300 auditors and 1,900 audit firms registered with IRBA.

Under the APA, a part-time board governs IRBA. The Minister of Finance appoints the IRBA Board, which is made up of a minimum of six and maximum of ten members. According to the Act, the IRBA Board may not include more than 40 percent practicing auditors. IRBA is legally mandated to have various permanent committees to support its different roles, including a:

- Disciplinary Committee;
- Investigation Committee;
- Inspection Committee;
- Committee for Auditing Standards; and
- Committee for Auditor Ethics (section 20).

These committees are appointed by the Board. The APA does not place limits on who may be appointed to the Investigation and Inspection Committees. Several of the key committees, most notably the Discipline and Investigation Committees, have practicing auditors as members.

IRBA has a permanent secretariat headed by a chief executive officer with approximately 65 full-time staff.

Under the statute, the IRBA is funded by:

- The collection of prescribed fees and levies from RAs and audit firms;
- Money appropriated for that purpose by the Parliament; and
- All other money which may accrue to the IRBA from any other legal source,

	<p>including sanctions imposed by IRBA (APA, section 25).</p> <p>IRBA is partially funded by the government (30 percent), and the rest of the funding is derived directly from audit firms by charging them a percentage of their public interest assurance fees (30 percent) as well as annual registration fees from RAs (40 percent). The budget is approved by the IRBA Board and submitted to the National Treasury. The inspection fees are not charged directly for an inspection, but based on a percentage of the firm's assurance fees. The aim of this funding model is to put additional distance between IRBA and the profession it regulates. The registration fees are set by the Board annually using a separate process. Questions have been raised whether this funding model, with its material reliance on funding from the regulated profession, compromises IRBA's independence.</p> <p>IRBA reports annually to the Minister of Finance, who then tables the report in Parliament. IRBA publishes extensive information on its activities and standards on its website.</p> <p>While IRBA may have the present resources to carry out inspections of the higher risk RAs, it does not have enough staff to do the full range of inspections mandated by the APA. Further, IRBA faces significant challenges in hiring the experienced professional staff it needs to carry out its functions. Auditors with inspection/investigatory expertise are not readily available in South Africa. Also, IRBA's budgetary limitations make it difficult to hire the other specialist expertise it needs, such as information technology auditors or auditors with banking experience.</p> <p><b>Inspections</b></p> <p>The APA gives IRBA the authority to inspect any RA and mandates that IRBA inspect the auditors of public interest companies (which include listed companies) at least once every three years (section 47(1)). The APA requires that RAs cooperate with IRBA during inspections by producing any information requested, even if the requested documents include confidential information (section 47(3)).</p> <p>Quality reviews (inspections) are performed in three-year cycles on audit firms with the coverage/frequency of inspections determined by the level of public interest and risk. The risk factors taken into account include the size of the audit firm, the number of partners, the nature of its clients, the results of previous inspections and the audit firm's complaint history.</p> <p>IRBA has established a business intelligence unit to assist it in identifying and measuring the applicable risks in the market. Its activities are complemented by a risk reporting system tying the information contained in all departments of IRBA into the risk assessment process.</p> <p>IRBA has adopted guidelines that set out the scope, objectives, and process for inspections referencing international standards. IRBA-adopted guidelines (entitled the Manual of Information, which is updated each year) provide that a firm inspection</p>
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covers both the quality control system of the firm and a sample of audit engagements. The objectives are to inspect the design and implementation of the quality control system and a sample of audit engagements to monitor compliance with the relevant professional standards (e.g., IFAC International Standard on Quality Control 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements, and the ISA).

Qualified professionals employed on a full-time basis by IRBA carry out most of the inspections. There are eight inspectors.

The inspections process is as follows:

- Schedule an inspection in advance and notify the firm closer to the date;
- Gather and analyze relevant business intelligence and select engagements on a risk-basis;
- Request pre-inspection information from the firm. Firms must ensure that all relevant information and documentation are provided to the inspector before the inspection commences;
- Perform inspection of firm and/or engagements;
- Discuss findings with the relevant firm representative/s;
- Obtain comments from the firm on findings within the specified time frame;
- Prepare a formal inspection report (which includes findings and comments received) and make a recommendation on the inspection outcome;
- Perform internal consistency/quality control review;
- Present formal inspection report on an anonymous basis to the Inspection Committee at its quarterly meeting for a decision;
- Director: Inspections relays the Inspection Committee's decision to the firm; and.
- Receive undertaking from the firm to implement corrective action, where appropriate.

The Inspection Committee consists of a maximum of eight individuals, who must be qualified and experienced individuals. Under the APA, the majority of members are not to be in public practice of accountancy and at present no practicing auditors are members. The Committee participates in the inspection process by:

- Monitoring the progress of the inspections cycle;
- Considering whether the inspection reports and recommendations are consistent and of an appropriate quality;
- Considering the recommendations made by IRBA's inspectors and determining

the outcome of inspections; and

- Providing guidance and advice to IRBA's Inspections Department on challenges and contentious matters.

The Inspection Committee's decision can be:

- The results are satisfactory and the firm will be reviewed in a subsequent cycle;
- The results are not satisfactory and the Inspections Department must conduct a follow-up inspection after approximately 12 months; or
- To refer the matter to the Investigating Committee, which may result in disciplinary action by IRBA.

Matters are referred to the Investigation Committee, if the results of the inspection indicate the public may be at risk; there was a revisit and the required corrective actions had not been implemented; there had been flagrant disregard for professional standards and/or Codes; or the firm/RA refused to co-operate in the inspection process.

Approximately 400 inspections were conducted over the last year. Over time, fewer inspections have been done annually, but according to IRBA the depth of each inspection conducted has increased. The expectation is that the number of inspections will level out at about 350 in-depth reviews per year. The inspection statistics over the past five years are set out below.

#### IRBA Inspections Performed

	2009	2010	2011	2012	2013
Firms	22	38	22	6	14
Engagements	1004	654	640	625	440

Source: IRBA 2013 Annual Report

In 2010, IRBA adopted a Code of Professional Conduct and Disciplinary Rules (IRBA Code and Rules). The IRBA Code, which is based on Part A and B of the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants with additional requirements for auditors in South Africa, adopts a "threats and safeguards" approach to ensuring the independence of auditors. The IRBA Code and Rules were updated as of March 2014.

Also, the Companies Act, the JSE Listing Requirements and the statutory requirements applicable to regulated firms (such as those licensed under the Banks Act and the FMA), contain independence requirements for auditors appointed to act for public companies and regulated financial firms.

Auditors are required to document their independence in compliance with the IRBA Code and other regulatory requirements in their audit, review or other assurance engagements.

It is the responsibility of the IRBA Inspections Department to check the RAs' policies

and processes during the inspections of firms' and individual auditors' engagement files to determine if the independence requirements have been documented and met in the circumstances. IRBA has the authority to sanction any non-compliance found.

(See the discussion under Principle 20 on the independence standards that apply to auditors.)

### **Investigation and disciplinary process**

Under Chapter V of the APA, IRBA has the authority to investigate and sanction RAs for improper conduct. The Disciplinary Rules regarding unprofessional conduct adopted by IRBA provide guidance on the types of conduct that can be considered improper. These include: contravention of any law that the auditor is required to follow; failure to respond to a demand from IRBA for documents or the payment of fees or levies; any offence involving dishonesty; failure to perform any work or duties with due care and skill; and personal conduct that is improper, discreditable, unprofessional or dishonorable, or unworthy of a registered auditor or which brings the profession of accountancy into disrepute.

The APA requires IRBA to establish a committee to investigate suspected misconduct by RAs and recommend to the IRBA Board whether to charge the auditor with improper conduct (section 24). The Investigation Committee operates part-time and is supported by the IRBA Legal Department. The APA allows IRBA to determine the number and make-up of the Committee members.

Investigations may be initiated in response to public complaints, from information generated through IRBA inspections or from other sources. The APA does not give the Investigation Committee the power to subpoena documents or compel testimony, but does state that the Committee may require that registered auditors provide documents, including audit work papers.

Once the Investigation Committee completes its investigation, it submits a recommendation for or against prosecution of the auditor to the Disciplinary Advisory Committee (DAC) for consideration. The DAC is a sub-committee of the IRBA Board designated to act on its behalf. Currently, the DAC is composed of four IRBA Board members, two of whom are practicing auditors. If the recommendation is to prosecute, the case must be prosecuted at the Disciplinary Committee, unless that recommendation is reconsidered. The DAC may also settle (finalize) cases by agreement. In the 2013 financial year, the DAC considered 66 cases and finalized 61. Of the cases finalized, four practitioners were admonished, 23 were found guilty by consent (negotiated settlement), and 37 were not prosecuted. One case was dropped as the practitioner had died. The DAC referred three matters to the Disciplinary Committee for prosecution.

Under section 50 of the APA, the Disciplinary Committee is the tribunal for prosecutions of RAs. The APA dictates that the Committee must have as its chair a former judge or senior advocate and that a majority of members must not be RAs

(section 24).

The history over the past three years of the misconduct investigated and sanctioned by IRBA is set out below.

#### Misconduct Investigated and Sanctioned

Offences	2011		2012		2013	
	I*	S*	I	S	I	S
Failing To Perform with Due Care and Skill	46	11	49	17	56	16
Dishonesty	10	1	3		2	2
Non-Independence	7	2	4	1	5	3
Fee Dispute	4	1	1			
Failure to Reply To Correspondence or Telephone Calls	2	1	1		1	
General Unacceptable Conduct	2		4	1	3	
Refusal to Resign	2		7	4	1	
Criticism of Colleagues	1		1	1		
Practice Review Complaint			1	1	5	4
Partnership Dispute			1		1	
Companies Act Contraventions					1	
Black Economic Empowerment					2	
<b>Total</b>	<b>74</b>	<b>16</b>	<b>73</b>	<b>25</b>	<b>77</b>	<b>25</b>

Source: IRBA.

\* I= Investigated, S=Sanctioned

Most of the sanctions imposed are fines. Over the past three years, one RA was reprimanded, one was suspended and three were removed from the register of RAs.

Under section 51(3) of the APA, potential sanctions include monetary fines up to ZAR 100,000 per charge, reprimands, suspension of registration, and cancellation of registration. These levels are well below what can be imposed by the FSB's EC.

IRBA has discretion whether to publish the name of the sanctioned auditor. In most cases, IRBA publishes a description of the charges and sanctions without disclosing the name of the auditor. In the 2013 financial year, of the four cases adjudicated, the auditor's name was published in two cases. In both cases, while the auditor's registration was canceled, payment of the fines imposed was suspended. For cases that are settled by consent orders before reaching the Disciplinary Committee, it is IRBA's policy to not disclose the names of the auditors sanctioned, owing to concerns that the publicity surrounding a sanction might make the clients of an auditor flee the practice, regardless of how minor the offence. A review of the sanctions that have been imposed indicates a tendency to levy a relatively small fine on the auditor.

Where the auditor acts for an issuer listed on the JSE and there has been evidence of improper conduct, the exchange may withdraw the auditor's recognition under the JSE rules to act for that listed firm, or any listed firm.

Assessment	Partly Implemented
Comments	<p>IRBA's authority to share the results of inspections is presently limited under section 47. They cannot be shared with the audit committee of the entity audited, nor can IRBA share this information proactively with other regulators. Under section 47 it may only share the information on receipt of a written request. Consideration should be given to expanding IRBA's authority to share information, particularly on a proactive basis with other regulators.</p> <p>The independence of IRBA would be enhanced by amending its funding model to include additional sources beyond the government and the auditing profession. Consideration might be given to levying a fee on those market participants that benefit from higher standards of auditing, such as public companies, to broaden IRBA's funding base. For example, in the United States, the largest source of funding for the Public Company Audit Oversight Board (PCAOB) comes from the companies whose financial statements must be audited by PCAOB-registered firms. Registered securities brokers and dealers are also required to contribute to the PCAOB.</p> <p>As with all regulatory boards, the IRBA must balance the need for members with expertise on the issues for which it is responsible with the requirement to be independent in appearance and in fact from the regulated profession. The Board and many key committees of the IRBA include practicing RAs. Consideration should be given to reducing their participation, particularly on committees responsible for investigations and disciplinary matters.</p> <p>IRBA should be given additional resources and greater freedom to contract with staff on appropriate terms in order to recruit and retain staff with the necessary expertise. While the IRBA board members and employees are covered by legal immunity provisions, there is no provision for the IRBA to pay those persons' legal costs if sued. Consideration should be given to including provisions permitting the IRBA to indemnify these persons for their legal costs in the event they are sued and make those moneys available to pay costs during the course of the suit.</p>
<b>Principle 20.</b>	Auditors should be independent of the issuing entity that they audit.
Description	<p>The IRBA Code (referred to in Principle 19) contains extensive restrictions relating to audit firms and individuals within the audit firm regarding financial, business or other relationships with an entity that the firm audits (see section 290). These include extensive requirements governing financial and other relationships with the audited firm and the provision of other (non-audit) services to that firm (set out in paragraphs 290.156 - 290.219).</p> <p>The IRBA Code adopts a "threats and safeguards" approach to ensuring the independence of auditors. Paragraph 290.7 of the IRBA Code requires the firm/auditor to:</p>

	<ul style="list-style-type: none"> <li>• Identify the threat to independence from a given relationship or circumstance;</li> <li>• Evaluate its significance; and</li> <li>• Apply safeguards to eliminate the threats or reduce them to an acceptable level.</li> </ul> <p>Where appropriate safeguards are not available or cannot be applied to reduce the threats to an acceptable level, the auditor is required to either eliminate the circumstance or relationship creating the threats or decline or terminate the audit engagement. Sections 290 and 291 contain detailed provisions that govern how these independence requirements are to be met and what must be done, if an RA identifies a breach of the independence standards.</p> <p>The Code defines each of the following categories of threats and addresses, in turn, how they are to be assessed and dealt with:</p> <ul style="list-style-type: none"> <li>• Self-interest;</li> <li>• Self-review;</li> <li>• Advocacy;</li> <li>• Familiarity; and</li> <li>• Intimidation.</li> </ul> <p>Under the IRBA Code and the ISA, an audit firm is required to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with the prescribed ethical requirements. The policies and procedures must enable the firm to communicate its independence requirements to its personnel, identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.</p> <p>In addition, the audit firm must establish policies and procedures designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm is competent to perform the engagement; has the capabilities, including time and resources, to do so; can comply with the relevant ethical requirements (independence and lack of conflicts of interest); and has considered the integrity of the client.</p> <p>The audit firm must establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to its quality control systems are relevant, adequate and operating effectively.</p> <p>The Companies Act, the JSE Listing Requirements and the statutory requirements applicable to regulated firms also contain independence requirements for auditors appointed to act for these public companies and financial firms.</p>
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	<p>Auditors are required to document their independence in compliance with the IRBA Code and other regulatory requirements in their audit, review or other assurance engagements.</p> <p>The Companies Act requires individual audit partners (not the entire firm unless it is a sole proprietorship) to rotate from audit engagements after five consecutive years. There is a two-year cooling off period, if the individual leaves the engagement after having served for two or more consecutive years as the lead partner (section 92). The IRBA Code mandates a maximum term of seven years followed by a two year cooling off period (paragraph 290.151).</p> <p>The Companies Act (section 94) requires public companies (including both listed and unlisted companies) and state-owned companies to establish audit committees. Any other company may also voluntarily establish an audit committee provided it is specified in its MOI. The audit committee is to be composed of directors who are not involved in the day-to-day management of the company (section 94(4)). Among the statutory responsibilities of the committee are to nominate the external auditor for approval by the shareholders at the annual general meeting, determine the audit fee, pre-approve any non-audit services to be provided by the company auditor, and assess the independence of the auditor (section 94(7), (8)).</p> <p>Further, the King III Code and the JSE Listing Requirements contain requirements for the audit committee of a listed company to approve the appointment of the auditor. Individual registered auditors and their audit firms have to be accredited by the JSE and meet the requirements set out in Section 22 of the Listing Requirements. In order to be approved, the RA must have been inspected by and have a clean record with IRBA. In addition, the SARB and the FSB, among others, must give prior approval to the appointment of an auditor for a regulated firm (see, for example, section 19(2) of the FAIS Act).</p> <p>An unlisted public company must give notice of a change of auditor, but the notice only must be filed within 10 days after the change (Companies Act, section 85(3)) and no other public disclosure is required (see Principle 16).</p> <p>Section 3.75 of the JSE Listing Requirements requires a listed company to notify the JSE without delay of the resignation or termination of the listed company's auditor. At the latest, the notice is due the next business day after the decision has been made. The notice to the JSE must be accompanied by a letter from the auditor stating the date of termination and what the auditor believes to be the reason for such termination or resignation (3.76). The JSE may, at its discretion, request the issuer to publish an announcement informing shareholders of the termination or resignation of the auditor and the reason for the change (3.78). The annual financial statements for the year end in which the termination or resignation took place must include the same information (3.79).</p> <p>There is a mechanism in place for enforcing compliance with auditor independence</p>
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	<p>standards. The IRBA Code and Disciplinary Rules stipulate remedial measures for problems detected and to carry out disciplinary proceedings on auditors. Complaints may be lodged by any member of the public, by other entities, or by the Inspections Department of IRBA. These complaints are investigated and referred for disciplinary action if warranted under the APA. See the discussion under Principle 19.</p> <p>As noted under Principle 18, the JSE has established a panel (FRIP) that monitors compliance by issuers with financial reporting standards and the related auditor's reports. Problems detected that relate to auditors are referred to IRBA to investigate the technical issues and where appropriate to carry out investigations and disciplinary proceedings.</p> <p>IRBA is also working on building its relationships with other relevant regulators to improve its effectiveness of its processes and intelligence. It has also established MOUs to facilitate information sharing. However, as noted under Principle 19, its ability to share information is somewhat constrained under the APA.</p>
Assessment	Broadly Implemented]
Comments	Reporting of a change in the auditor of an entity that has issued its securities to the public should be both timely and publicly made. The JSE requirements are both; the requirements under the Companies Act meet neither standard. The Companies Act should be amended to require prompt, public disclosure of a change of auditor. This provision could usefully be included in the general obligation to disclose material information changes that is recommended under Principle 16.
<b>Principle 21.</b>	Audit standards should be of a high and internationally acceptable quality.
Description	<p>The ISA issued in 2009 by the IAASB have been officially adopted for use in South Africa.</p> <p>The Auditing and Assurance Standards Board of the PAAB adopted the original text of the IAASB International Standards on Quality Control, Auditing, Assurance and Related Services as the standards to be applied by all auditors in South Africa from January 1, 2005.</p> <p>Following the passage of the APA, IRBA confirmed its predecessor's adoption of the International Engagement Standards issued by the IAASB, as published in the successive IAASB Handbooks of International Quality Control, Auditing, Assurance, and Ethics Pronouncements (the IAASB Handbooks). The continued adoption of the IAASB Handbooks for use by all auditors in South Africa is done in accordance with section 4(1)(e) of the APA and effected by gazetting periodic IRBA Board Notices.</p> <p>By virtue of adopting the successive IAASB Handbooks, the Board deemed them to have been prescribed without requiring publication of the entire Handbook. The adoption and prescription is communicated to auditors by Board Notice from time to</p>

	<p>time. Board Notices will be issued and gazetted on this basis for so long as the IAASB Handbooks continue to be adopted and prescribed by IRBA for use by auditors.</p> <p>The above covers all the IAASB's International Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements.</p> <p>Section 22 of the APA provides for the establishment of a Committee for Auditing Standards (CFAS) at IRBA. The CFAS assists IRBA to develop, maintain, adopt, issue or prescribe auditing pronouncements. The CFAS assists and advises IRBA in its standard setting activities. The APA provides that the CFAS should have at least 12 members and sets out the required characteristics for certain members. The Committee members are not full-time employees of IRBA. The primary functions of the Committee include reviewing ISAs and other pronouncements as issued by the IAASB and advising the IRBA Board on their adoption; preparing comments on the IAASB exposure drafts; and developing and drafting IRBA pronouncements (i.e., guides, practice notes, and communiqués). The Standards Department of IRBA provides the Secretariat function to the CFAS. The committee follows a robust procedural and consultative process.</p> <p>There is a mechanism in place for reviewing audit performance and compliance with auditing standards. Under sections 47 – 49 of the APA, IRBA has the authority to inspect the practice of an RA and is required to do so at least every three years, if the RA audits a public interest company. The APA also provides for the investigation of improper conduct by an RA and the taking of disciplinary action as required. See the discussion under Principle 19.</p>
Assessment	Fully Implemented
Comments	
<b>Principle 22.</b>	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.
Description	<p><b>Definitions of credit rating and credit rating agency</b></p> <p>Section 1(1) of the CRSA includes a definition of credit rating and credit rating agency. Credit rating means an opinion regarding the creditworthiness of an entity, a security or a financial instrument, or an issuer of a security or a financial instrument, using an established and defined ranking system of rating categories, excluding any recommendation to purchase, sell, or hold any security or financial instrument. A CRA means a person who provides credit rating services, while credit rating services refers to data and information analysis, evaluation, approval, issuing or review for the purposes of credit ratings.</p> <p>Further, an external CRA means a person who provides credit rating services and who is authorized or registered by a regulatory authority to perform credit rating services</p>

similar to those regulated under the CRSA and who is subject to the laws of a country other than South Africa, which laws establish a regulatory framework which is approved by the Registrar as being equivalent to that established by the CRSA, and is supervised and monitored by a regulatory authority. An external credit rating refers to a credit rating issued by an external CRA.

The use of published credit ratings for regulatory purposes by a regulated person is covered in Section 4 of the CRSA, which requires that such credit ratings are issued or endorsed by a CRA registered in accordance with the CRSA, or issued or endorsed by an external CRA approved by the Registrar. The Registrar may prescribe additional requirements in respect of the use of credit ratings for regulatory purposes.

The CRSA applies to:

- Credit rating services performed in South Africa;
- Credit ratings that are issued by CRAs registered in South Africa; and
- Any person that performs credit rating services or issues credit ratings that are published in South Africa.

The CRSA came into force on April 15, 2013. A first transitional period was provided until December 17, 2013 and the first two CRAs (Fitch and GCR) were registered on December 13, 2013. Other credit rating agencies (Moody's and S&P) were provided exemptions from the December 17, 2013 deadline and were ultimately licensed on May 6, 2014. S&P registered as an external CRA, since it operates in South Africa through a branch of its European subsidiary, whereas all the other CRAs have South African subsidiaries, which have been registered as local CRAs. These subsidiaries have varying amount of staff in South Africa.

### **Registration of CRAs**

Section 5 of the CRSA includes the requirements for the application for registration as a registered CRA. An application must be made in the form and manner prescribed by the Registrar be accompanied by:

- A certificate of incorporation of the applicant under the Companies Act, if the applicant is located in South Africa, or proof of registration of the applicant as an external company under the Companies Act, if the applicant is an external CRA.
- Details of the applicant's:
  - Incorporation, registration, authorization or approval in countries other than South Africa to undertake credit rating services, if applicable;
  - Ownership structure, organizational structure and corporate governance;
  - Subsidiaries, if any;
  - Resources and expertise to perform credit rating services;

	<ul style="list-style-type: none"> <li>• Program of operations, including indications of where the main business activities are expected to be carried out, where branches will be established and what type of business will be undertaken;</li> <li>• Expected outsourcing arrangements, including details of the persons that will be assuming outsourcing functions;</li> <li>• Policies and procedures to identify, manage and disclose any conflicts of interest;</li> <li>• Compensation and performance evaluation arrangements; and</li> <li>• Compliance with or adherence to the code of conduct prescribed in the CRSA.</li> </ul> <ul style="list-style-type: none"> <li>• A description of the procedures and methodologies to be used to issue and review credit ratings;</li> <li>• Information to satisfy the Registrar that the applicant, its directors and employees comply with the fit and proper requirements prescribed by the Registrar, in respect of: <ul style="list-style-type: none"> <li>• Personal character qualities of honesty and integrity;</li> <li>• Competence;</li> <li>• Operational ability; and</li> <li>• Financial soundness;</li> </ul> </li> <li>• The application fee prescribed by the Registrar; and</li> <li>• Any other information prescribed by the Registrar.</li> </ul> <p>The Registrar may exempt an applicant that, or whose holding company or a related company in the same group, is registered by a foreign regulatory authority as a CRA from providing some or all of the above information, if the applicant requests an exemption and provides proof of such registration and the Registrar is satisfied that the registration was granted in accordance with public regulation that is equivalent to the CRSA. (Section 5(3) CRSA). The Registrar has provided some limited exemptions under this provision.</p> <p>According to Section 5(6) of the CRSA, before making a decision on the application the Registrar must consult with any local regulatory authority that relies on, refers to or uses credit ratings in its supervision and regulatory activities.<sup>30</sup> If the Registrar is satisfied that an applicant complies with the CRSA requirements, he/she must grant the application. If he/she is not satisfied, the Registrar must refuse the application, provided that the applicant is notified of the refusal, provided with written reasons for</p>
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<sup>30</sup> In practice such consultation has so far been undertaken informally with the SARB.

the refusal, and advised of the right to appeal. The Registrar may grant an application subject to any condition that he/she may determine. The Registrar must maintain a list on the FSB official website of all registered CRAs.

*Suspension and cancellation of registration*

According to Section 6 of the CRSA, the Registrar may at any time, after any required consultation of the authorities referred to above, suspend or cancel the registration of a registered CRA, if it:

- Expressly renounces the registration or has provided no credit rating services for the preceding six months;
- Has obtained the registration by providing false information or by any other irregular means;
- No longer meets the conditions under which it was registered;
- Has failed to comply with any condition imposed or directive issued under the CRSA; or
- Has been liquidated.

Such suspension or cancellation may be subject to any conditions that the Registrar may determine. The PAJA procedural requirements apply.

*Endorsement of external credit ratings*

Section 18 of the CRSA provides that a registered CRA may, subject to the approval of the Registrar, endorse external credit ratings, if:

- The credit rating services to be endorsed are undertaken partly or entirely by the registered CRA or by an external CRA belonging to the same group as the registered CRA;
- The registered CRA has verified and is able to demonstrate on an ongoing basis to the Registrar that the external CRA is authorized or registered by a regulatory authority to perform credit rating services similar to those regulated under the CRSA and is subject to the laws of a country other than South Africa, which establish a regulatory framework equivalent to that established by the CRSA and are supervised by a regulatory authority;
- The ability of the Registrar to assess and monitor the compliance of the external CRA with such foreign regulatory framework referred is not limited;
- The registered CRA provides the Registrar, on the Registrar's request, with all information necessary to enable the Registrar to monitor, on an ongoing basis, compliance with the CRSA;
- There is an objective reason for the credit ratings to be issued in a country other than South Africa, or by an external CRA; and

- A cooperation agreement has been entered into between the Registrar and the relevant regulatory authority of the external CRA, which provides at least for mechanisms for the exchange of information and procedures for the coordination of regulatory activities to facilitate the monitoring of credit rating activities resulting in the issuing of the endorsed credit rating on an ongoing basis.

No registered CRA has yet sought one of the above approvals.

### **Ongoing supervision and enforcement**

Under Section 23 of the CRSA, the Registrar is required to supervise and enforce compliance with the Act. It may by notice require any person, including a registered CRA, to provide within determined period specified information or documents necessary for the Registrar to exercise his/her powers under the CRSA. The Registrar may also take any measures that he/she considers necessary for the proper performance and exercise of the Registrar's powers and functions for the implementation of the CRSA.

Section 25 of the CRSA includes the power of the Registrar to conduct on-site visits and instruct an inspector to conduct an inspection (see Principle 10). After an on-site visit or inspection has been carried out, the Registrar may direct the person concerned to take any steps, to refrain from performing or continuing to perform any act or to terminate or remedy any contravention of or failure to comply with any provision of the CRSA. The EC also has certain powers vis-à-vis CRAs as provided in the Protection of Funds Act.

The Credit Rating Services Unit of the FSB established on April 1, 2013 is responsible for supervising CRAs. Its current business plan (for the financial year commencing on April 1, 2014) covers the following supervisory and regulatory functions.

- Registration of CRAs;
- Undertaking an annual assessment and review of the registered CRAs;
- Conducting on-site reviews on selected CRAs;
- Monitoring market developments to ensure that the local markets remain safe, sound, fair and efficient and that best practice standards are adopted in the management of risks;
- Assessing the South African legislation in terms of the IOSCO Principles with the aim of complying with best international standards;
- Monitoring compliance with the legislation and subordinate regulation/Board Notices;
- Undertaking other functions relating to the administration of the CRSA; and
- Handling and responding to complaints and queries from investors and

	<p>consumers.</p> <p>The Credit Rating Services Unit plans to conduct risk assessments on all registered CRAs and risk rate them according to the impact they have on investors and the probability of risks materializing. In the assessment of probability, it takes into account the internal controls in place and how effective they are in preventing the risks from materializing or mitigating its impact. The unit will disclose the risk assessment outcomes to each CRA on a confidential basis.</p> <p>At the time of the assessment mission, one CRA had been subject to a limited on-site visit. A second CRA is planned to be subject to an on-site visit during the second quarter of 2014, and the two remaining ones are intended to be visited during the third quarter of 2014. Further on-site visits will be driven by the results of the respective first visits and also by matters arising from any comments or complaints received from market participants, investors, the public and consumers.</p> <p><b>Oversight requirements</b></p> <p>The relevant oversight requirements that comply with the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies are in the CRSA and in the Board Notice 228 (Credit Rating Agency Rules) issued under Section 24 of the CRSA.</p> <p><i>Quality and integrity</i></p> <p>Section 9 of the CRSA includes requirements on the credit rating methodologies, models and key rating assumptions. A registered CRA must:</p> <ul style="list-style-type: none"> <li>• Adopt, implement and enforce adequate measures to ensure that the credit ratings it issues are based on a thorough analysis of all the information that is available to it and that is relevant to its analysis according to its rating methodologies;</li> <li>• Use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experience, including back-testing;</li> <li>• Regularly review its methodologies, models and key rating assumptions such as mathematical or correlation assumptions, any significant changes or modifications to them and their appropriateness, if they are used or are intended to be used for the assessment of new financial instruments; and</li> <li>• Establish internal arrangements to monitor the impact of changes in macro-economic or financial market conditions on credit ratings.</li> </ul> <p>A registered CRA must publish any credit rating or any decision to discontinue a credit rating impartially and in a timely manner. When publishing a credit rating, it must state clearly and prominently any attributes and limitations of the credit rating and provide an explanation of the key elements underlying the credit rating. A CRA must also regularly review its credit ratings. A registered CRA must disclose its policies and procedures regarding unsolicited credit ratings.</p>
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Section 14 of the CRSA requires a registered CRA to arrange for adequate records and, where appropriate, audit trails of its credit rating services, which must be kept for a minimum period of five years or such longer period as may be prescribed in any other applicable law. Part VII of the CRA Rules includes detailed requirements on record-keeping.

According to Section 5(1) of the CRSA, an application for registration as a registered CRA must include details on the CRA's resources and expertise to perform credit rating services. The CRA Rules include a requirement for the CRA to ensure that it has and devotes sufficient resources to carry out high-quality credit analysis of all obligations of the rated entity it rates. In relation to monitoring, surveillance and updating, a CRA is required to ensure that adequate personnel and financial resources are allocated to monitoring, surveilling and updating its ratings, except for ratings that clearly indicate they do not entail ongoing monitoring and surveillance. Once a rating which requires ongoing monitoring and surveillance is published, the CRA must monitor and surveil the rating on an ongoing basis and update it by regularly reviewing the rated entity's creditworthiness, initiating a review of the status of the rating upon becoming aware of any information that might reasonably be expected to result in a rating action, including termination of a rating, and updating on a timely basis the rating, as appropriate, based on the results of such review.

#### *Conflicts of interest*

According to Section 5(1) of the CRSA, an application for registration as a registered CRA must include details of the CRA's policies and procedures to identify, manage and disclose any conflicts of interest. Section 7 of the CRSA requires a registered CRA to be organized in a way that ensures that its business interest does not impair the independence and integrity of its credit ratings or the accuracy of its credit rating services. In addition, no person, including the Registrar, may hinder, interfere with, obstruct or improperly attempt to influence a credit rating, the content of a credit rating, or any methodology, model or key assumption used by a registered CRA to derive a credit rating (Section 20 CRSA).

More detailed requirements on independence and avoidance of conflicts of interest are included in Part III of the CRA Rules. A CRA must identify, eliminate or manage and record and disclose, clearly and prominently, any actual or potential conflicts of interest that may influence the analysis and judgments of its analysts, employees, or any other natural person whose services are placed at the disposal or under the control of the CRA, and who are directly involved in the issuing of credit ratings and persons approving credit ratings. A CRA's disclosures of actual and potential conflicts of interest must be complete, timely, clear, concise, specific and prominent.

A CRA may not issue a credit rating in any of the following circumstances, or must, in the case of an existing credit rating, immediately publicly disclose where the credit rating is potentially affected by the following:

	<ul style="list-style-type: none"> <li>• The CRA or its analysts, employees or other persons referred to above directly or indirectly own securities or financial instruments in the rated entity or a related third party or have any other direct or indirect ownership interest in that entity or party, other than holdings in CIS, pension funds or life insurance;</li> <li>• The rated entity or a related third party is directly or indirectly linked to the CRA by control;</li> <li>• An analyst, employee or other person referred to above is a member of the senior management of the rated entity or a related third party; or</li> <li>• An analyst who participated in determining a credit rating, or a person who approved a credit rating, has had a relationship with the rated entity or a related third party that may cause a conflict of interest.</li> </ul> <p>A CRA must not refrain from taking a rating action based on the potential effect (economic, political, or otherwise) of its action on a rated entity, an investor, or other market participant. The credit rating that a CRA assigns must not be affected by the existence of or potential for a business relationship between the CRA (or its affiliates) and the rated entity (or its affiliates) or any other party, or the non-existence of such a relationship.</p> <p>An analyst or an employee of a CRA, or the spouse, partner or minor child of an analyst or employee, may not buy, sell or engage in any transaction in any securities guaranteed or otherwise supported by a rated entity within the analyst's area of primary analytical responsibility, other than holdings in CIS, pension funds or life insurance. A CRA must ensure that an analyst employed by the CRA is not compensated or evaluated on the basis of the amount of revenue that the CRA derives from issuers that the analyst rates or with which the analyst regularly interacts. A CRA must conduct formal and periodic reviews of its compensation policies and practices for analysts and other employees, who participate in or who might otherwise have an effect on the rating process, to ensure that these policies and practices do not compromise the objectivity of the agency's rating process. A CRA may not have employees, who are directly involved in the rating process, also involved in discussions regarding fees or payments with any rated entity, or potential rated entity, related third party or any person directly or indirectly linked to the rated entity by control.</p> <p>A CRA employee may not participate in, or otherwise influence, the determination of the CRA's rating of any particular rated entity, if the employee:</p> <ul style="list-style-type: none"> <li>• Owns securities or financial instruments of the rated entity, other than holdings in diversified CIS, pension funds or life insurance;</li> <li>• Owns securities or financial instruments of any entity related to a rated entity, the ownership of which may cause or may be perceived as causing a conflict of interest, other than holdings in diversified CIS, pension funds or life insurance;</li> <li>• Has had a recent employment or other significant business relationship with</li> </ul>
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	<p>the rated entity that may cause or may be perceived as causing a conflict of interest;</p> <ul style="list-style-type: none"> <li>• Has an immediate relation, such as a spouse, partner, parent, child, or sibling, who currently works for the rated entity where this employment relationship constitutes a conflict of interest; or</li> <li>• Has, or had, any other relationship with the rated entity or any of its related entities that may cause or may be perceived as causing a conflict of interest.</li> </ul> <p><i>Transparency and timeliness</i></p> <p>Section 13 of the CRSA prescribes certain disclosure requirements for CRAs. A registered CRA must disclose to the public and its subscribers the following:</p> <ul style="list-style-type: none"> <li>• The practices, procedures, processes, methodologies, models and key rating assumptions it uses in its credit ratings and credit rating services and any material modifications to them;</li> <li>• Its code of conduct;</li> <li>• The general nature of its compensation arrangements;</li> <li>• Its policy on publishing credit ratings and other related communication; and</li> <li>• Every 12 months, data about the historical default rates of its rating categories.</li> </ul> <p>Section 10(1) of the CRSA further requires that a registered CRA must publish any credit rating or any decision to discontinue a credit rating impartially and in a timely manner.</p> <p>Part XI of the CRA Rules provides more detailed requirements on the transparency and timeliness of credit rating disclosures. A CRA must:</p> <ul style="list-style-type: none"> <li>• Distribute its credit rating decisions in a timely manner;</li> <li>• Publicly disclose its policies for distributing credit ratings, reports and updates;</li> <li>• Disclose to the public, on a non-selective basis and free of charge, any credit rating regarding publicly issued securities, or publicly rated entities, as well as any subsequent decisions to discontinue such a credit rating, if the rating action is based in whole or in part on material non-public information; and</li> <li>• Publish sufficient information about its procedures, methodologies and assumptions so that outside parties can understand how a credit rating was arrived at. This information must include the meaning of each rating category, rating outlook and the definition of default or recovery and the time horizon the agency used when making a rating decision.</li> </ul> <p>The information on the historical default rates must include:</p> <ul style="list-style-type: none"> <li>• Verifiable, quantifiable and historical information about the performance of the CRA's credit ratings, organized and structured, and, where possible,</li> </ul>
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	<p>standardized in such a way as to assist investors in drawing performance comparisons between different credit rating agencies;</p> <ul style="list-style-type: none"> <li>• An indication whether the default rates of these categories have changed over time; and</li> <li>• The credit ratings transition frequency.</li> </ul> <p><i>Confidential information</i></p> <p>A CRA is required to establish appropriate and effective organizational and administrative requirements to protect confidential information made available to it by issuers, including prohibiting its analysts and employees from using such information to enter into transactions (Section 7(f)(ii)). Section 19 of the CRA Rules covers more detailed confidentiality requirements. A CRA must adopt procedures and mechanisms to comply with the above CRSA confidentiality requirement to protect the confidential nature of information shared with it by issuers under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. It also stipulates that, unless otherwise permitted by the confidentiality agreement and consistent with applicable laws or regulations, a CRA or its employee may not disclose confidential information in press releases, through research conferences, to future employers, or in conversations with investors, other issuers, or other persons. A CRA may use confidential information only for purposes related to its rating activities or otherwise in accordance with any confidentiality agreements with the issuer.</p>
Assessment	Broadly Implemented
Comments	The legislative and regulatory framework established in South Africa complies with the requirements of the IOSCO Assessment Methodology. However, the FSB registered the last two CRAs only in early May 2014, and has only recently started implementing its supervisory program. It therefore needs to ensure the implementation of its supervisory plan, including conducting sufficient on-site visits and other ongoing supervision to reach full implementation of this Principle. The supervisory plan should apply to all registered CRAs, either directly or in cooperation with foreign authorities, independent of the nature of the CRA's physical presence in South Africa (subsidiary, branch, staffing level, etc.).
<b>Principle 23.</b>	Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.
Description	Advice is a regulated business under the FMA and the FAIS Act. However, the definition of advice under those statutes is fairly narrow and turns on advice aimed at a particular investor or group of investors based on the firm's understanding of the investor's risk profile and investment objectives. In other words, 'advice' must be

targeted at one or more investors with a known risk profile and investment objectives before it triggers the obligation to be licensed under the legislation. This would not normally catch the types of research reports currently issued in South Africa that are limited to reports regarding listed equity securities and made available generally only to the clients of the firm that prepared the report.

Under the FAIS Act, an analysis or report on a financial product is specifically excluded from the definition of advice provided such analysis does not express or imply a recommendation, guidance or proposal that any particular transaction in the product is appropriate for the particular investment objectives, financial situation or needs of a client (section 1(3)(a)(ii)). The JSE Rules contain requirements governing advice provided by members to their clients (see for example, Equities Rule 8.130), but they do not directly apply to research reports as that activity is not caught by the definition of advice, for the same reason as under the FAIS Act.

As a result, there are no requirements that expressly apply to sell-side securities analysts unless they also are advising as defined. However, there are general standards in the statutes, the Codes of Conduct made under the FAIS Act and the JSE Rules that govern regulated firms' activities that address conflicts of interest and conduct of business regarding clients more generally. These would apply at a firm-wide basis to FSPs licensed under the FAIS Act and to JSE members. As a result, the firms issuing the reports would be responsible for ensuring that the reports otherwise meet the conduct of business obligations owed to clients (see Principle 31) and obligations under the law regarding misrepresentations, etc. Further, the firms would be responsible for any investment recommendation/advice made to specific clients, whether based on a research report or not. (See the discussion of the know your client and suitability obligations in Principle 31.)

The JSE Equities Rules address recommendations made by member firms in relation to JSE listed equities that address potential conflicts of interest. However, the rules do not explicitly address the specific matters listed in the Assessment Methodology under this Principle.

- Rule 8.20.6 requires the member firm to disclose whether it has an interest in the security in respect of which a recommendation is given;
- Rule 8.10.2 requires a member to act honestly and fairly towards its clients and exercise independent professional judgment;
- Rule 8.10.5 requires the member to avoid conflicts of interest and when they cannot be avoided, ensure the fair treatment of its clients by disclosure, confidentiality or declining to act, and not unfairly place its own interests above those of its clients; and.
- Rule 8.40 requires a member to implement controls regarding the personal account trading of its employees to avoid conflicts of interest with its clients.

	<p>These rules are applicable to all employees of a member firm. The JSE's authority is limited to its members. If the entities that provide research services and information to clients are not JSE members, these rules would not apply.</p> <p>More generally, the South African securities markets and regulation do not rely on other experts such as business valuers or asset valuers that are not otherwise regulated. Many local hedge fund managers make use of third party administrators that are responsible for valuing the assets of the funds. These third party administrators would themselves be registered (at least) as Category I FSPs under the FAIS Act and subject to supervision by the FSB and the general conflict of interest rules applicable to FSPs.</p> <p>The FAIS Act gives the Registrar the authority to exempt activities and products from the licensing requirements (section 1(3)). However, the Registrar does not have the authority to do the reverse: read into the Act new or problematic activities so that these would trigger the licensing requirement. Extending the ambit of the Act would require legislative change.</p> <p>However, the Registrar does have authority to prescribe codes of conduct that apply to various categories of FSPs to govern business conduct at the firm level and has exercised this authority where appropriate.</p> <p>See also the discussion under Principle 7.</p>
Assessment	Broadly Implemented
Comments	<p>The overall system in South Africa does not rely to any material degree on providers of analytical or evaluative services. Research reports are not widely prepared or circulated. Those that are prepared generally relate to listed instruments and are issued by JSE members and made available only to their clients. There is no specific conflict of interest or oversight regime that applies to this activity, but where it is provided by a regulated entity, it would be subject to the general duties on conflicts of interest and business conduct.</p> <p>The role of analysts and providers of other evaluative services should be part of the overall perimeter of regulation review process required under Principle 7 and the review of the remit of the FSB legislation referred to above. Action should be taken, if and when such activities become a more important factor in the marketplace.</p>
<b>Principles for Collective Investment Schemes</b>	
<b>Principle 24.</b>	The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.

Description	<p><b>Collective investment schemes in South Africa</b></p> <p>CISCA defines a CIS widely. A CIS is a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest, and the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed, but not a CIS authorized by any other Act (Section 1 CISCA). Currently all CIS are unit trusts, even though the above definition would permit other legal forms, such as an open-ended investment company.<sup>31</sup></p> <p>CISCA identifies four types of CIS:</p> <ul style="list-style-type: none"> <li>• CIS in securities;</li> <li>• CIS in property;</li> <li>• CIS in participation bonds; and</li> <li>• Declared CIS.</li> </ul> <p>A CIS in securities is a scheme the portfolio of which consists mainly of securities (Section 39 CISCA). A CIS in property includes<sup>32</sup> a scheme whose portfolio consists of property shares, immovable property, other assets determined by the Registrar of CIS or any similar investment in a foreign country with a foreign currency sovereign rating by a CRA complying with the requirements set by the Registrar (Sections 47 and 49 CISCA). A CIS in participation bonds means a scheme whose portfolio consists mainly of participation bonds (Section 52 CISCA). Finally, a declared CIS means a CIS other than a CIS in securities, property or participation bonds, which has been declared to be a CIS by the Minister of Finance by notice in the Gazette (Sections 62-63 CISCA). The predominant form of CIS is CIS in securities. There are currently no declared CIS.<sup>33</sup></p> <p>According to the FSB, there are other arrangements in South Africa where assets of various investors are pooled together and invested collectively. For example, the</p>
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<sup>31</sup> The ability to use open-ended investment companies is limited because the Companies Act does not provide appropriately for this structure. Similarly, according to the market participants CISCA does not sufficiently allow the structure to be used, as it assumes a unit trust structure and assigns the same responsibilities to trustees and custodians.

<sup>32</sup> For CIS in property, CISCA uses the word include rather than mean as in the case of CIS in securities and CIS in participation bonds.

<sup>33</sup> However, see Principle 28 with regards to the planned treatment of hedge funds. In addition, consideration has been given to regulating private equity funds as declared CIS.

	<p>existing hedge funds fall into this category. However, these asset pools are set up as private arrangements and do not therefore fall under the above definition of CIS, which requires that the CIS is available to the public.</p> <p><b>Registration</b></p> <p><i>Fund manager</i></p> <p>A person that administers a CIS has to be registered as a manager by the Registrar, be an authorized agent or be exempted from CISCAs (Sections 5(1), 41(1), 48(1) and (53(1)). According to Section 1 of CISCAs, administration means any function performed in connection with a CIS including:</p> <ul style="list-style-type: none"> <li>• The management or control of a CIS;</li> <li>• The receipt, payment or investment of money or other assets, including income accruals, in respect of a CIS;</li> <li>• The sale, repurchase, issue or cancellation of a participatory interest in a CIS and the giving of advice or disclosure of information on any of those matters to investors or potential investors; and</li> <li>• The buying and selling of assets or the handing over of them to a trustee or custodian for safe custody.</li> </ul> <p>According to Section 86 of CISCAs, a manager may conduct business other than administration subject to the prior approval of the Registrar. In practice the majority of the fund managers are also authorized as Category I FSPs (see Principle 29) for providing advice on their own CIS. These authorizations are granted under the FAIS Act. The FSB informed that it has not granted any other approvals under Section 86 of CISCAs.</p> <p>Separate registration is required to be a manager of each category of CIS. A CIS manager has to be a company under the Companies Act (Sections 41(2), 48(2) and 53(2) CISCAs). The same requirement would apply to any manager of a declared CIS.</p> <p>The Registrar must, on such conditions as he or she may determine, register an applicant as a manager of CIS in securities (Section 42 CISCAs) if:</p> <ul style="list-style-type: none"> <li>• The Registrar is satisfied that the deed<sup>34</sup> which the applicant proposes to prepare for the purposes of the CIS in securities does not contain anything inconsistent with CISCAs;</li> <li>• The proposed directors, management, trustee or custodian and auditors are qualified;</li> </ul>
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<sup>34</sup> A deed means the agreement between a manager and a trustee or custodian, or the document of incorporation whereby a CIS is established and in terms of which it is administered (Section 1 CISCAs). In practice, CIS managers use a standard form trust deed published by the FSB.

<ul style="list-style-type: none"> <li>• The applicant is fit to assume the duties and responsibilities of a manager; and</li> <li>• The registration of the applicant as a manager will be in the public interest.</li> </ul> <p>The requirements of Section 42 of CISCA apply also to CIS in property and participation bonds (Sections 51 and 64 CISCA).</p> <p>Board Notice 911 of 2010 requires the application form as a CIS manager to include the names and curriculum vitae of the chairperson, directors and managing director of the manager. In addition, the CIS manager must submit the names and curriculum vitae of all managerial staff responsible for administration with specific reference to experience related to their responsibilities. Directors<sup>35</sup> must also submit a completed fit and proper form (Annexure of the FSB Board Notice 910 on the Determination of Fit and Proper Requirements and Conditions for Managers of Collective Investment Schemes – Notice 910). Criteria leading to automatic disqualification (e.g., conviction in a criminal or civil proceeding for fraud or breach of fiduciary duty) are included in Part IV of Notice 910.</p> <p>Section 4 of CISCA includes the duties of a CIS manager. It must:</p> <ul style="list-style-type: none"> <li>• Avoid conflict between the interests of the manager and the interests of an investor;</li> <li>• Disclose the interests of its directors and management to the investors;</li> <li>• Maintain adequate financial resources to meet its commitments and to manage the risks to which its CIS is exposed;</li> <li>• Organize and control the CIS in a responsible manner;</li> <li>• Keep proper records;<sup>36</sup></li> <li>• Employ adequately trained staff and ensure that they are properly supervised;</li> <li>• Have well-defined compliance procedures;</li> <li>• Maintain an open and cooperative relationship with the office of the Registrar and promptly inform it about anything that might reasonably be expected to be disclosed to such office; and</li> <li>• Promote investor education, either directly or through initiatives undertaken by an association.</li> </ul>
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<sup>35</sup> The FSB informed that in practice all managing directors of fund management companies are also directors and therefore this requirement in practice also extends to CEOs.

<sup>36</sup> A CIS manager is subject to the requirement of section 24 of the Companies Act, according to which any documents, accounts, books, writing, records or other information that a company is required to keep under the Companies Act or any other public regulation must be kept for a period of seven years. Section 74 of CISCA includes a requirement for the manager to preserve the accounting records in respect of itself and every collective investment scheme administered by it in a safe place for a period of at least five years.

	<p>Parts V, VII and VIII of Notice 910 include the following more detailed requirements for a manager:</p> <ul style="list-style-type: none"> <li>• Comply with standards of internal organization and operational conduct that aim to protect the interests of investors and ensure proper management of risk;</li> <li>• Conduct business in a way that protects the interests of investors and helps preserve the integrity of the CIS;</li> <li>• Be responsible for ensuring appropriate internal policies and procedures for compliance with relevant legislation and appropriate internal controls and risk management systems;</li> <li>• Ensure that the internal control structures, procedures and controls are in place, including documentation relating to business processes, policies and controls, technical requirements, system application testing, disaster recovery and back-up procedures on electronic data, appropriate training for all staff regarding the relevant legislative requirements, and a business continuity plan;</li> <li>• Record all financial and system procedures to ensure that it is able to report according to the applicable accounting requirements;</li> <li>• Ensure that the necessary controls and compliance procedures are in place to manage and monitor the relevant systems in use;</li> <li>• Have general administration processing, accounting transactions and risk control measurements in place to ensure accurate, complete and timely processing of data, information reporting and assurance of data integrity;</li> <li>• Have periodic evaluation of risk management processes executed by an independent party (e.g., auditors or independent risk management consultants) to ensure compliance with all relevant legislation;</li> <li>• Have and effectively employ resources, procedures and appropriate technological systems that can reasonably be expected to eliminate the risk that investors may suffer financial loss through theft, fraud, other dishonest acts, poor administration, negligence, professional misconduct or culpable omissions, and to protect the interests of investors in general; and</li> <li>• Have adequate storage and filing systems for the safe-keeping of records, business communications and correspondence and adequate access to communication facilities.</li> </ul> <p>Part III of Notice 910 requires the Board of Directors of a manager to have a minimum of four directors, with at least 50 percent of them being non-executive directors. The majority of the non-executive directors must be independent. There must be sufficient CIS, legal and accounting experience and expertise amongst the Board members.</p> <p>Section 88 of CISCA specifies that the manager must on an ongoing basis maintain</p>
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capital in liquid form for the matters and risks determined by the Registrar. A manager may not be registered or allowed to continue as a manager, unless at the time of registration and at all times thereafter the manager has net assets in liquid form which exceed the minimum capital requirement determined by the Registrar (Section 89 CISCA). The capital requirements for the managers of CIS in securities, property and participation bonds have been determined in FSB Board Notices (Notices 2072, 2074 and 2076 of 2003, respectively). For example, a manager of CIS in securities must always maintain capital that is at least ZAR 600,000 or a sum equivalent of 13 weeks' fixed costs<sup>37</sup> for the whole of the CIS business of a manager. In addition, the manager must invest seed capital of ZAR 1 million in each portfolio administered by it. This seed capital may be reduced by 10 percent for every ZAR 1 million invested in the portfolio by investors that are not connected to the manager. Therefore the seed capital may be reduced to zero when the portfolio reaches ZAR 10 million. Finally, if the manager holds participatory interests in its own portfolio, it has to maintain position risk capital equivalent to a certain percentage (between 10 and 25 percent) of the amount it paid for those participatory interests. Similar requirements apply to managers of CIS in property and participation bonds.

Part V of Notice 910 also requires that a manager and its shareholders are not under liquidation or provisional liquidation and that the assets of the manager itself and any direct and indirect shareholders of the manager must exceed the liabilities of the shareholder or manager.

The Registrar may exempt the managers of a particular category of CIS from the above capital requirements and determine different capital requirements for such managers. The Registrar may exempt a manager from compliance with the requirements for such period, not exceeding six months, and on such conditions as he/she may lay down.

#### *Trustee*

A CIS manager must appoint a trustee<sup>38</sup> for its CIS. A person may not become or act as a trustee unless that person is registered as such (Section 68 CISCA). A trustee must (Section 69 CISCA):

- Be a public company under the Companies Act; a company or institution incorporated under a special Act, excluding a close corporation referred to in the Close Corporations Act; an institution or branch of a foreign institution which is entitled to carry on the business of a bank under the Banks Act, 1990, or an institution which is registered as an insurer under the Long-term Insurance Act, 1998;

<sup>37</sup> The Board Notices include detailed requirements on what is considered to be fixed costs.

<sup>38</sup> CISCA refers to the possibility to also appoint a custodian, but since in practice all CIS are currently unit trusts, their managers must appoint a trustee. Therefore all references to trustee or custodian from CISCA have been replaced with references to trustee in this report.

	<ul style="list-style-type: none"> <li>• Maintain capital and reserves together amounting to not less than ZAR 10 million; and</li> <li>• Have such general financial and commercial standing and independence that it is fit for performing the functions of a trustee and be by reason of the nature of its business sufficiently experienced and equipped to perform such functions.</li> </ul> <p>The Registrar may not register a company or institution as a trustee for a CIS, if it is either a holding company or a subsidiary of the manager within the meaning of those terms as defined in the Companies Act (see Principle 25). In practice all trustees are banks.</p> <p><i>Asset manager</i></p> <p>The asset manager to which a CIS manager has delegated the management of the CIS assets has to be an authorized FSP. This is controlled by requiring that the application form for registration as a CIS manager include the name of the FSP that will perform the asset management of the portfolio(s) and confirmation of its authorization as such (Section 1(k) of Notice 911). In practice the CIS Department liaises with the FAIS Department to confirm the authorization of the asset manager as an FSP.</p> <p><i>CIS</i></p> <p>CIS are not subject to a formal registration requirement in South Africa. However, as noted above, the Registrar has to be satisfied that the deed of an applicant for registration as a fund manager does not contain anything inconsistent with CISCA. The main deed to be submitted to the Registrar as part of the application governs the scheme to be managed by the manager. The Registrar requires in practice that the main deed complies with a standard deed published on its website.<sup>39</sup> Under a scheme, a manager may establish various portfolios, each of which requires a supplemental deed that has to be submitted to the FSB for approval. Annexure E of Notice 569 of 2003 includes a list of information that must accompany an application for the approval of each individual portfolio.</p> <p><i>Marketing a South African CIS</i></p> <p>Marketing and distributing CIS managed by a South African CIS manager can be undertaken only by the manager itself or an FSP authorized for selling CIS. JSE members may also distribute CIS.</p> <p><i>Marketing a foreign CIS</i></p> <p>The Registrar may approve an application by the manager or operator of a foreign CIS to solicit investments in such scheme from members of the public in South Africa, if</p>
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<sup>39</sup> This standard deed was originally prepared jointly by the FSB and the Association of Collective Investment of South Africa (that has since merged to ASISA).

the application is in the form determined by the Registrar, a copy of the approval or registration by the relevant foreign jurisdiction authorizing the foreign CIS to act as such is submitted, and the foreign CIS can comply with the conditions determined by the Registrar (Section 65 CISCA).

Section 2 of the Conditions for Foreign CIS (Board Notice 257) includes the conditions for the Registrar's approval:

- The operator applying for the approval of a scheme must be authorized and supervised by a regulator which has a regulatory environment of similar standing as the regulatory environment of South Africa;
- The scheme in which the operator intends to solicit investments must be available for investment in its domicile of registration and be promoted in South Africa to the same type of investors under the same or substantially similar requirements and conditions relating to the type of investors as in its domicile of registration;
- The operator must enter into a representative agreement or establish and maintain a representative office; and
- The operator must satisfy the Registrar that the scheme is sufficiently liquid to meet investor redemptions, does redemptions at regular intervals, and does not permit investment in an instrument that compels the acceptance of physical delivery of a commodity; the scheme particulars or prospectus prohibit it from accepting physical delivery; and the assets of investors are properly protected by application of the principle of segregation and identification.

The Registrar may require written confirmation from the foreign regulator that the operator is fit and proper and in good standing with such regulator and may take into consideration any other information regarding the operator, derived from whatever source, provided such information is disclosed to the applicant that is provided a reasonable opportunity to respond to the information.

The application for approval of a scheme must be in writing and, to the extent applicable, include:

- The full name of the scheme and portfolio, the operator, the regulator to which the operator is subject in the operator's country of registration, the trustee or body that provides the fiduciary oversight to the scheme, and the custodian of the scheme;
- A detailed explanation of the manner in which the operator will solicit investments in the scheme from members of the public in South Africa;
- Description of the legal and operational structure of the scheme;
- Where a representative office has been established, details of the

	<p>representative office of the scheme;</p> <ul style="list-style-type: none"> <li>• Where a representative agreement has been concluded, details of the manager with which the operator has entered into the representative agreement, and a copy of the representative agreement;</li> <li>• Written confirmation from the applicable regulator verifying that the scheme has been approved and authorized in accordance with the legislation of the domicile of registration of the scheme, is subject to supervision by the regulator in the relevant jurisdiction and is by applicable law permitted to solicit investment in the respective jurisdiction and outside its domicile of registration.</li> <li>• A certified copy of the approval or registration of the scheme;</li> <li>• A certified copy of the fund rules and instruments of incorporation of the operator;</li> <li>• The prospectus and any amendments to the prospectus;</li> <li>• A document listing the differences and similarities between the scheme and a local CIS registered under CISCA;</li> <li>• A questionnaire relating to the scheme, completed on a form that may be obtained from the Registrar;</li> <li>• The latest annual financial report or equivalent report and any subsequent half yearly report of the scheme;</li> <li>• A copy of any other document affecting the rights of investors in the scheme;</li> <li>• Confirmation by the auditor of the representative office that the representative office complies with the requirement to have at least ZAR 2 million of paid-up share capital and reserves; and</li> <li>• Such further information as the Registrar may require.</li> </ul> <p><b>FSB registration process</b></p> <p>A company which desires to be registered as a manager of a CIS in securities must lodge with the Registrar an application for registration (Section 42 CISCA). The staff of the CIS Division's Registration and Compliance teams goes through the application against a checklist that covers the relevant CISCA requirements (fitness and propriety of directors, authorization of the asset manager under the FAIS Act, compliance of the deed with the standard deed, compliance of the investment policy with Board Notice 80 requirements, etc.). No on-site visit is conducted prior to registration.</p> <p>After the CIS department has processed the application, the application is submitted to the FSB Licensing Committee that reviews the application and provides its recommendation to the Registrar on whether to approve the registration or not. The final registration decision is made by the Registrar or Deputy Registrar (as per the</p>
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delegation of authority under Section 112(3) of CISCA). There is no specific deadline in CISCA within which the FSB has to process a registration application, but the CIS Division has publically committed to do this within three months.

### **Conflicts of interest**

There is a general requirement in Section 4(1) of CISCA that requires a manager to avoid conflicts between the interests of the manager and the interests of an investor. There are also requirements that touch specific conflict of interest situations, in particular the requirement in Section 4(2) of CISCA that requires the manager to disclose the interests of its directors and management to investors and the requirement in Section 92 of CISCA that prohibits a CIS manager, director or employee of the CIS manager from directly or indirectly having a personal interest in or deriving any pecuniary advantage from the acquisition or sale of any assets of a portfolio. There are no other requirements on the prohibition, management and disclosure of conflicts of interest in CISCA or the applicable Board Notices.

### **Conduct of business**

Section 2 of CISCA includes general principles applicable to the administration of CIS. They require that a manager administers a CIS honestly and fairly, with skill, care and diligence and in the interest of investors and the CIS industry and that the assets of an investor are properly protected by application of the principle of segregation and identification.

There are no specific regulatory requirements on most of the issues covered in Key Question 14 of the Assessment Methodology, i.e., best execution, appropriate trading and timely allocation of transactions, churning, related party transactions, commission rebates, soft commission arrangements and inducements.

In case an investment manager invests in a portfolio in which the manager is linked by common management or control or indirect holding, the manager or other company may not charge subscription or redemption fees on the underlying portfolio. Further, the preamble to the Board Notice 80 of 2012 requires a manager to ensure that all investments in a CIS portfolio have been subjected to adequate due diligence in line with the applicable investment objective of the portfolio.

The deed for a CIS in securities must contain provisions regarding the charges that may be levied and their method of calculation. Every investor must be given at least three months' written notice of an increase in any charge and of any change in the method of calculation, which could result in an increase or the introduction of any additional charge. (Schedule 1, Sections 1(i)-(j)) CISCA).

### **Delegation**

Section 4(5) of CISCA includes requirements on delegation. A manager may, with the approval of the Registrar and in writing, delegate any administrative function (see above for the definition of administration) to any person. Anything done or omitted to

be done by such delegated person in the performance of a function so delegated must be regarded as having been done or omitted by the manager. The Registrar has in respect of a delegated person all the powers and duties conferred or imposed upon the Registrar in respect of a manager.<sup>40</sup> There is no specific prohibition of systematic and complete delegation of the core functions of a CIS manager.

The delegations are effected through contractual arrangements and the manager is therefore able to terminate them and make alternative arrangements, subject to the prior approval of the Registrar. There are no specific regulatory requirements for disclosing the delegation arrangements and the identity of the delegates to investors, but in practice the fund fact sheet template developed by ASISA covers disclosure of this information.

### **Supervision and ongoing monitoring**

#### *Periodic reporting*

A CIS manager must submit the calculation of its capital position to the Registrar as at the last business day of each calendar month within 14 business days after the end of the month (Board Notices 2072, 2074 and 2076).

A manager must within 90 days after the close of its financial year send to the Registrar a copy of its duly audited financial statements and those of every portfolio of the CIS administered by the manager. It must also, on or before a date specified by the Registrar, lodge with the Registrar such further information and explanations in connection with the financial and other statements referred to as the Registrar may request. (Section 90 CISCA).

A trustee or custodian is required to prepare a report on the administration of the CIS by the manager during each annual accounting period, which must state whether the CIS has been administered in accordance with the limitations imposed on the investment and borrowing powers of the manager by CISCA and the CIS deed. If the manager does not comply with these requirements, the report must state the reason for non-compliance and outline the steps taken by the manager to rectify the situation. This report has to be sent to the Registrar and to the manager in good time to enable the manager to include a copy of the report in its annual report.

A manager of a CIS in securities must, within 30 days after the end of each calendar quarter, furnish to the Registrar a full list of all underlying assets included in any portfolio administered by it. The report has to include the market value of each asset included in each portfolio as well as the value of each asset expressed as a percentage of the total value of assets in the portfolio and as a percentage of the total amount of assets of that class issued by the group in which the investment is held. The report has to indicate which assets are exchange securities and on which exchange such assets

<sup>40</sup> These provisions were added to CISCA in the General Amendment Act that came into force on February 28, 2014.

are listed. If any asset is not listed on an exchange, the manager must indicate the mechanism used in the pricing of such asset. (Notice 569 of 2013). The FSB does not currently use any system for the analysis of these reports that would create automatic alerts in case of breaches of the relevant regulatory requirements.

#### *Approval and reporting of changes*

Section 43 of CISCA includes the requirements on the CIS manager to seek the prior approval of the Registrar before making certain changes. A manager may not without the prior approval in writing of the Registrar change its shareholding, directors or the name under which it is registered, use or refer to itself by a name other than the one under which it is registered or its literal translation, use or refer to itself by an abbreviation or a derivative of such name, or change the name of its CIS in securities or any portfolio administered by it as approved by the Registrar.

In terms of ad hoc reporting, the auditor must report to the manager any irregularity or undesirable practice in the administration of the CIS which has come to his/her notice in the ordinary course of fulfilling his/her audit responsibilities or performing other functions in terms of CISCA. He/she must submit a copy of such report to the Registrar, if there is reasonable cause to believe that the report is or might be of material significance to the Registrar. A report is of material significance to the Registrar, if it deals with a matter that, because of its nature or potential financial impact, has caused or is likely to cause financial loss to the scheme or any of its investors or creditors. (Section 75 CISCA). A similar requirement applies to the trustee under Section 70(2) of CISCA, under which a trustee must report to the manager any irregularity or undesirable practice concerning the CIS of which it is aware. Further, if the manager does not take steps to rectify the irregularity or practice, the trustee has to report it to the Registrar as soon as possible.

#### *On-site reviews and inspections*

Section 14 of CISCA refers to the power of the Registrar to conduct an on-site visit under Chapter 1A of the Protection of Funds Act or instruct an inspector to conduct an inspection under the Inspection Act (see Principle 10). After an on-site visit or inspection has been carried out, the Registrar may direct the person concerned to take any steps, to refrain from performing or continuing to perform any act or to terminate or remedy any contravention of or failure to comply with any provision of CISCA (except those reserved to the EC in Section 6D(2)(b) of the Protection of Funds Act).

The Registrar may also direct a manager to have all books of accounts and financial statements audited and to submit the results of such an audit to the Registrar within the time specified by the Registrar (Section 19 CISCA).

In the financial year 2013/2014, the FSB conducted on-site visits of all 57 registered managers. Two of these were due to a complaint or tip-off. All managers were included in the program for the year, as the on-site visits were general reviews.

According to the FSB, the on-site visits covered the CIS managers' risk management

processes and internal controls, with a specific objective to assess whether the managers had developed and implemented adequate control systems to mitigate risks inherent to the administration of CIS. The usual length of each on-site visit was one day. No major findings were identified. The on-site visit reports reviewed during the assessment mission were very short and it was therefore not possible to conclude what the depth of the reviews was in practice.

Themes of any thematic reviews are normally selected on the basis of concerns uncovered during the regular on-site visit program, desk-based review of statutory reports, complaints from the members of the public, press reports of cases of abuse or violations, and the prevailing trends and innovations in CIS industry. Last thematic reviews on CIS managers were undertaken in 2011, when 39 thematic reviews were conducted. The theme covered was fees charged by CIS managers, with the objective to determine whether CIS managers charged fees as per the constituting documents and as disclosed to investors, and whether the fees charged were permissible in terms of the governing legislation.

The table below contains information on the on-site visits conducted on CIS managers in the last three years.

#### FSB Inspections in CIS Managers

	2011/ 2012	2012/ 2013	2013/ 2014	Total
Periodic inspections	0	54	55	109
Complaints	1	1	2	4
Thematic visits on fees	39	0	0	39
<b>Total</b>	<b>40</b>	<b>55</b>	<b>57</b>	<b>152</b>

Source: FSB

No on-site visits have been undertaken in trustees.

#### *Enforcement*

Section 15 of CISCA includes the powers of the Registrar after investigation. If the Registrar, after an on-site visit or inspection under Section 14, considers on reasonable grounds that the interests of the investors of a CIS or of members of the public so require, the Registrar may:

- Apply to the court under the Companies Act for the winding-up of a manager or of a CIS;
- Apply to the court under Section 5 of the Protection of Funds Act for the appointment of a curator for the business of the manager or for the business of a portfolio;
- Require a manager to appoint, in accordance with the Registrar's directions, in place of the serving trustee, a competent person nominated by the Registrar;
- Require a manager to take steps, in accordance with the Registrar's directions

and the provisions of Section 102 of CISCAs, for the winding-up of a portfolio of its CIS, and for the realization of its assets and the distribution of its net proceeds, together with any income accruals or other moneys available for distribution among the investors in proportion to their respective participatory interests;

- Direct a manager, trustee or custodian to take any steps, or to refrain from performing or continuing to perform any act, in order to terminate or remedy any irregularity or undesirable practice or state of affairs disclosed by an investigation or inspection (except those reserved for the EC in the Protection of Funds Act);
- Direct a manager to withdraw from the administration of a CIS, whereupon the trustee or custodian must in accordance with the Registrar's directions but subject to CISCAs arrange for another manager to take over the administration of the CIS;
- If a person administers a CIS in contravention of CISCAs, apply to the court to have the CIS wound up, in which case the court may make any order it considers appropriate for the winding-up of the CIS;
- Instruct a manager to wind up a portfolio or amalgamate a portfolio with another portfolio; or
- If a manager fails to comply with a written request, direction or directive by the Registrar under CISCAs, do or cause to be done all that a manager was required to do in terms of the request, direction or directive of the Registrar.

Additional enforcement powers are in Sections 15A, 16 and 18 of CISCAs. The Registrar may, subject to the conditions stipulated in CISCAs:

- Issue a directive to any person to whom the CISCAs applies;
- Cancel the registration of a manager; and
- Impose a fine for a failure to submit within a specified period any required statement, report, return or other document or information.

In the past three years, the Registrar has identified and sanctioned the following misconduct by CIS managers:

#### Misconduct by CIS Managers

Type of misconduct	2011	2012	2013	Total
Late submission of statutory reports	0	2	2	4
Marketing an unauthorized foreign CIS	0	0	2	2
Appointing auditors without approval	0	0	1	1
Changing shareholding without approval	0	0	1	1
Total	0	2	6	8

Source: FSB

The late submissions of statutory reports led to fines by the Registrar. The other cases

	have been passed on to the EC that has so far sanctioned one case of marketing an unauthorized foreign CIS in 2011-2013. In addition, in 2014 it has given one sanction for an unauthorized name change.
Assessment	Partly Implemented
Comments	<p>The legislative and regulatory framework, although not as detailed as in some other jurisdictions, addresses many issues covered in the IOSCO Assessment Methodology. However, there is a need to significantly enhance the requirements to prohibit, restrict or manage conflicts of interest as required by Key Question 12 of the IOSCO Assessment Methodology. The same applies to the need to introduce specific record-keeping and conduct of business requirements applicable to CIS management, as required in Key Questions 11 and 14 of the Assessment Methodology.</p> <p>Regular on-site visits are conducted in all CIS managers. However, there appears to be room to enhance the depth of the issues considered during these visits, also to reach the same level of intensity that other Registrars apply to their supervisory activities. In addition, it would be important to extend the FSB on-site visit program to CIS trustees.</p>
<b>Principle 25.</b>	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p><b>Legal form</b></p> <p>As noted in Principle 24, there are no specific restrictions on the permitted legal forms for CIS in South Africa. Neither are there any particular disclosure requirements on the legal form and structure of a CIS to investors, since disclosure requirements applicable to CIS are limited (see Principle 26). In practice all CIS have been unit trusts. The standard deed requires certain information on the structure of the CIS to be included. As noted in Principle 24, the FSB reviews the deed at initial authorization and when any supplemental deeds are prepared.</p> <p>Section 98(2)(a) of Cisca provides that the parties to a deed may by supplemental deed amend it, but no amendment is valid unless the majority in value of investors has consented to the amendment in a manner prescribed in the deed. Sections 67 and 42 of the standard deeds for CIS in securities and property, respectively, include more detailed provisions on amending the deed and balloting the investors. When a ballot is necessary, the CIS manager must dispatch to every investor a memorandum approved by the Registrar containing the reasons for the proposed amendment. Section 99 of Cisca further provides that the amalgamation of the business of two or more CIS or portfolios and the cession, transfer and takeover of the rights of investors in a portfolio require the prior consent of both the Registrar and the investors holding a majority in value of participatory interests in each CIS or portfolio to which the proposed change refers. Board Notice 577 of 2003 includes specific investor notification requirements in case of a termination of a CIS in participation bonds.</p>

	<p>The standard deeds for securities and property include a clause according to which the manager must give not less than three months' written notice to investors of any increase in the manager's charge or any change in the method of its calculation that could result in an increase of this charge or of the introduction of any new charge. There are no other specific requirements to give notice to investors on other changes that have an impact on their rights, but as noted above, all amendments to the deed itself require the approval of the majority in value of investors and the Registrar.</p> <p><b>Compliance with investment restrictions</b></p> <p>Section 46 of CISCAs provides that the Registrar may determine the manner in which and the limits and conditions subject to which securities or classes of securities may be included in a portfolio of a CIS in securities. The Registrar may determine different manners, limits and conditions for different securities or classes of securities or different portfolios. These determinations are made in Board Notice 80.<sup>41</sup></p> <p>Section 45 of CISCAs includes restrictions on the foreign equity and non-equity securities in which a CIS in securities may invest. Foreign equity securities must be traded on an exchange which has been granted full membership of the World Federation of Exchanges or listed on an exchange to which the manager has applied the due diligence guidelines determined by the Registrar. Investments in non-equity securities are permitted, if the country where the issuer is located has a minimum foreign currency sovereign rating and the issuer has a minimum long-term issuer credit rating on the international scale. The minimum ratings and the permitted credit rating agencies are determined by the FSB. If the country or the issuer has been rated by more than one agency, the lower of the ratings applies. The manager also has to apply due diligence guidelines for issuers of non-equity securities determined by the Registrar.</p> <p>A manager of a CIS in property may invest the CIS assets in immovable property in a foreign country and property shares or participatory interests in a CIS in property in a foreign country, if such foreign country has a minimum foreign currency sovereign rating by an approved rating agency (Section 49 CISCAs).</p> <p>Under Section 70 of CISCAs, the primary responsibility for monitoring compliance with the investment restrictions lies with the trustee. It must enquire into and prepare a report on the manager's administration of the CIS during each annual accounting period, which must state whether the CIS has been administered in accordance with the CISCAs limitations on the manager's investment and borrowing powers, other CISCAs provisions and the deed. If the manager does not comply with such limitations and provisions, the report must state the reason for the non-compliance and outline</p>
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<sup>41</sup> The full title of this Board Notice is: Determination of Securities, Classes of Securities, Assets or Classes of Assets that May be Included in a Portfolio of a CIS in Securities and the Manner in which and Limits and Conditions Subject to which Securities and Assets May Be Included.

the steps taken by the manager to rectify the situation. The report must be sent to the Registrar and to the manager in good time to enable the manager to include a copy of the report in its annual report.

The FSB is able to monitor compliance with the investment restrictions on the basis of the quarterly reports furnished under Section 3 of the FSB Board Notice 569 (see Principle 24).

### **Segregation and safekeeping of assets**

Section 2(2) of CISCA requires the assets of an investor to be properly protected by application of the principle of segregation and identification. Section 104 further provides that any money or other assets an investor hands to a manager, trustee or their authorized agent for the sale or repurchase of a participatory interest and the assets of a portfolio must be excluded from the assets of the manager and trustee. Paragraph 14 of the standard deed provides that the assets of a portfolio must be registered either in the name of the trustee or, with the written consent of the Registrar, in the name of a nominee company of the trustee.

A manager must open and maintain a separate operational trust account controlled by the trustee for each or for all the portfolios administered under its CIS at a registered bank (Section 105 CISCA). The FSB informed that in practice the trustees open a separate trust account for each portfolio. On the date of receipt of any payment from or on behalf of an investor or on the first business day thereafter, the trustee must deposit the funds in such account. These funds may only be withdrawn for the purposes of making payment to the investor, person or manager entitled to such payment, or as provided in CISCA, any other law or the deed.

As noted in Principle 24, the Registrar may not register any company or institution as a trustee for a CIS, unless he/she is satisfied that the company or institution is not either a holding company or a subsidiary of the manager. However, as currently drafted, this provision does not appear to prevent any other related company (such as a sister company) from being the trustee. In practice the Registrar has not permitted this.

There are no particular requirements on the use of sub-custodians other than the requirement in Section 68(6) of CISCA, according to which the trustee may appoint a representative that is independent of the manager and any of its agents to perform any or all of the trustee's duties, when it is impracticable for the trustee itself to perform them. A trustee that has appointed a representative is not divested of its duties.

### **Winding up**

If no period has been fixed for the duration of a CIS portfolio, the manager or trustee may, on application to the Registrar and subject to such terms and conditions as the Registrar may determine, wind up that portfolio at any time (Section 102 CISCA). In addition, any competent division of the court may, on the application of a manager or

	<p>trustee, order any fixed duration portfolio to be wound up, if the court is satisfied that to do so would be in the interest of investors in that portfolio.</p> <p>Upon the winding up of a portfolio, the manager must realize as soon as possible all its assets under the control and supervision of the trustee, having regard to the interest of investors. The manager incurs no liability by reason of the exercise in good faith of its discretion as to the time of realization of any assets, unless the discretion is exercised in a grossly negligent manner. The net proceeds of the realization of such assets must be deposited in the trust account and must under the control and supervision of the trustee be distributed by the manager or trustee amongst the investors and the manager in proportion to their respective participatory or other interests in the portfolio.</p> <p>The above provisions would also apply to the winding up of a portfolio of an open-ended investment company.</p>
Assessment	Broadly Implemented
Comments	<p>On the basis of the current drafting of CISCA, it appears to be possible to use a sister company as a trustee of a CIS manager. In practice the Registrar has not permitted this, but the relevant provision would benefit from clarification to prevent any future legal challenges.</p> <p>There are currently no specific requirements on the use of subcustodians, other than that the trustee remains responsible for the acts of any subcustodian it may use. Considering the importance of the trustees' and custodians' role in safeguarding the client assets and funds, the authorities should consider the need to enhance the requirements in this regard (e.g., by requiring the subcustodian to be subject to appropriate regulation and supervision).</p>
<b>Principle 26.</b>	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	<p>Under section 50(1) of CISCA, a manager of a CIS in property must apply for permission for the participatory interests to be dealt in on a licensed exchange. As a result, all of them are listed at the JSE and subject to the JSE disclosure requirements (see Principle 16). The discussion below therefore focuses on other types of CIS.</p> <p><b>Initial disclosure obligations</b></p> <p>Section 3 of CISCA requires that, before entering into a transaction with an investor, information about the investment objectives of the CIS, the calculation of the net asset value and dealing prices, charges, risk factors and distribution of income accruals must be disclosed to the investor. Further, information that is necessary to enable the investor to make an informed decision must be given to the investor in a timely and</p>

	<p>comprehensible manner. CISCA does not specify how and by whom this information is to be provided, but in practice the obligation falls on the person marketing the fund, which is often an FSP.</p> <p>In terms of disclosure to the public, the main source of information to prospective investors is often the fund fact sheet prepared by CIS managers on the basis of ASISA templates.</p> <p>The standard deed template available on the FSB website includes a provision requiring that a copy of the deed must at all times during normal business hours be made available by the manager and trustee at their respective head offices for inspection by an investor or a prospective purchaser of a participatory interest.</p> <p>Section 97(1) of CISCA includes requirements on the matters which must be provided for in the CIS deed. Every deed must set out the requirements for the administration of a portfolio and include provisions to regulate the matters detailed in Schedule 1 of CISCA in respect of a CIS in securities and those detailed in Schedule 2 of CISCA in respect of a CIS in property.</p> <p>According to Schedule 1 of CISCA, the deed of a CIS in securities must provide for the requirements applicable to its administration, including:</p> <ul style="list-style-type: none"> <li>• The investment policy to be followed in respect of each portfolio;</li> <li>• The manner in which the assets of a portfolio are to be valued for purposes of calculating the selling and repurchase prices of participatory interests;</li> <li>• The frequency of calculation of selling and repurchase prices of participatory interests, and the point in time at which such calculations will be performed on a specific day (valuation point);</li> <li>• If assets other than securities listed on an exchange may be included in any portfolio, the basis on which the market value of such assets is to be determined for the purposes of determining selling and repurchase prices;</li> <li>• The manner in which and a point in time at which the valuation point will be applied either to the creation, sale, repurchase or cancellation of participatory interests;</li> <li>• The manner in which distributions are to be calculated and settled;</li> <li>• The limits, terms and conditions under which securities may be lent;</li> <li>• The limits, terms and conditions under which a manager may borrow money for the account of a portfolio;</li> <li>• The charges that may be levied and the method of calculation of those charges;</li> <li>• That not less than three months' written notice must be given to every investor of an increase in any charge and of any change in the method of calculation</li> </ul>
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which could result in an increase or the introduction of any additional charge; and

- The manner in which a deed may be amended.

Schedule 2 of CISCA includes the requirements on the administration of a CIS in property that must be included in its deed:

- The investment policy to be followed in respect of each portfolio;
- The frequency and basis on which the assets of a portfolio are to be valued;
- The manner in which participatory interests are to be created or cancelled;
- The manner in which distributions are to be calculated and settled;
- The limits, terms and conditions under which a manager may borrow money for the account of a portfolio;
- The charges that may be levied and the method of calculation of those charges;
- That not less than three months' written notice must be given to every investor of an increase in any charge and of any change in the method of calculation which could result in an increase or the introduction of any additional charge; and
- The manner in which a deed may be amended.

The Registrar may by notice in the Gazette exempt a particular type or category of CIS from the above requirements and determine the matters to be complied with or to be provided for in a deed by such type or category of CIS.

Since there are no specific regulatory requirements to prepare an offering document or equivalent on CIS in securities and participation bonds, the information required in Key Question 5 to be publicly available may not exist or may need to be derived from various sources. The main legally required information source would be the deed, which is not normally published e.g., on the CIS managers' websites. Therefore the investors are likely to place reliance on documents prepared without a specific regulatory requirement, such as a fund fact sheet. The deed does not include certain information required in Key Question 5, such as the audited financial information concerning the CIS. Neither is there any specific requirement to disclose the appointment of any external administrator, investment manager or adviser in the deed (but this information is normally available in the fund fact sheet).

#### *Role of the FSB*

As noted in Principle 24, the Registrar approves the CIS main deed and supplemental deeds for each portfolio. The Registrar also has a general power to object to certain documents under Section 17 of CISCA, according to which it may object the terms of any price list, advertisement, brochure or similar document relating to a CIS published

or proposed to be published by a manager or any of its authorized agents, if the Registrar considers the terms are calculated to mislead or are, for any other good and sufficient reason, objectionable or undesirable. In such case, the Registrar may direct the manager to discontinue or refrain from publishing or distributing any such document, or to amend its terms. This power has not been used.

### **Ongoing disclosure obligations**

The obligation of Section 3(a) of CISCA applies on an ongoing basis.

### **Periodic reporting**

On the basis of Section 90 of CISCA, a manager must, not later than 90 days after the close of the financial year of every portfolio of the CIS administered by the manager, send to every investor in such portfolio a report on the portfolio containing the information determined by the Registrar. Copies of this report, the financial statements of the manager and other relevant statements and information must be kept available at every office of the manager and its authorized agents for inspection during ordinary office hours by any investor in the CIS concerned or other person interested in investing in a participatory interest in such scheme.

Paragraph 4 of Notice 569 includes the requirements on the content of the above report that must be transmitted electronically or otherwise to every investor. It must include:

- A report by the chairman or managing director disclosing every material fact or circumstance that occurred during the year and that had an effect on the financial affairs of the portfolio and its manager and, in particular, details of any deviation from the investment policy and objective as contained in the deed;
- An abridged income statement and balance sheet of the portfolio;
- Details of any qualification made by the auditor in his report on the financial statements of the manager and the portfolio;
- The amount of each distribution by the portfolio and the date of distribution;
- Performance figures of the portfolio for the current and previous years, based on repurchase price to repurchase price, compared, where relevant, to a market index;
- Details of all charges levied by the manager, any charge levied on the repurchase of participatory interests and any change in such charges or in their calculation method;
- The composition of the assets of the portfolio classified by appropriate category or industry sector; and
- A statement that copies of the audited annual financial statements of the

manager and of the scheme managed by it are available, free of charge, on request by an investor.

Section 74 of CISCA requires that a manager must in respect of itself and every CIS it administers maintain the accounting records and prepare annual financial statements in conformity with generally accepted accounting practice, preserve such records in a safe place for a period of at least five years as from the date of the latest entry; and cause such records and annual financial statements to be audited, not later than three months after the financial year end of the manager or CIS, or such later date as the Registrar may allow, by an auditor whose appointment has been approved by the Registrar under Section 73 of CISCA. The reference to generally accepted accounting practice does not refer to any particular existing accounting standard in South Africa, and there is no requirement to prepare the financial statements of a CIS manager or CIS in accordance with the IFRS that have to be used by public companies (listed and unlisted) and financial institutions.

#### **Standard formats**

The deed has to follow the standard deed template. Otherwise there are no standard format requirements applicable to any initial or periodic disclosure documents.

#### **Advertisements**

Section 100 of CISCA includes the following requirements on the information that has to be covered in a price list, advertisement, brochure and similar document:

- The charges that may be levied by the manager, their method of calculation, amount and the time when they may be levied, if the price of any participatory interest is mentioned or a particular portfolio is referred to in any such document;
- Information on the basis on which the manager undertakes to repurchase participatory interests and the basis on which selling and repurchase prices will be calculated;
- Any reference to the yield to be derived from any participatory interest confined to the yield during the last preceding 12 months for which a distribution has been declared and a statement as to any facts likely to influence future yield (in the case of any such document published after the expiry of a period of 12 months following the date of the first offer of participatory interests to the public) or information as to the probable yield (in the case of any such document published within the first-mentioned period);
- If the document states that investors are entitled to participate in the CIS profits, amount of profits distributed during the previous financial year, expressed as a percentage of the aggregate market value, as at the close of that year, of all assets then held on behalf of investors in that portfolio; and
- A statement that the value of participatory interests is subject to fluctuation

	<p>relative to the market value of the assets comprised in the portfolio, unless the Registrar has exempted the manager or its agent from this requirement.</p> <p>Section 90(4) of CISCAs includes a requirement that a manager must lodge with the Registrar copies of all advertisements, brochures, pamphlets, circulars and announcements and of all proposed additions and changes to them published or proposed to be published by the manager or any of its authorized agents, unless the manager is exempted from such an obligation by the Registrar.</p> <p>In practice, all managers of CIS in securities that are ASISA members (i.e., all except one) have been exempted from the above requirements since 2003 under Board Notice 571 of 2003. Therefore the only requirement that currently applies to advertisements on CIS in securities is the prohibition in Section 106 of CISCAs to make a statement or disseminate information, if the person knows, or ought reasonably to know, it to be false or misleading. In addition, it is prohibited to make or publish a statement, promise or forecast likely or intended to be misleading, false or deceptive and conceal material information and induce another person to purchase or deal in a participatory interest.</p>
Assessment	Not Implemented
Comments	<p>The regulatory requirements applicable to the information to be provided on CIS in securities and participation bonds are limited to those relating to the content of the deed and the yearly report to investors. The onus on providing information to potential investors is on the person who sells the CIS unit to the investor rather than information provided in public disclosures. In many cases, the distributor may not have any connection to the CIS. The deed includes some relevant information, but it only needs to be available for inspection at the head offices of the manager and trustee.</p> <p>Significant gaps in relation to compliance with the requirements of Principle 26 relate to the lack of a requirement to prepare a legally mandated offering document, to prepare accounts in accordance with high quality, internationally acceptable accounting standards, to use standard formats for initial and periodic disclosures to investors, and to address inaccurate, false or misleading advertisements. The authorities should proceed to expeditiously address these gaps to improve compliance with this Principle.</p>
<b>Principle 27.</b>	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p><b>Asset valuation</b></p> <p>CISCAs require that a security must be valued at its fair market price. When a manager of a CIS in securities is unable to determine a market price for a listed or unlisted security, a fair market price for it must, at the request of the manager, be determined by a stockbroker who is a member of a licensed exchange. If the manager does not</p>

agree with the price determined by the stockbroker, it must refer the matter to the committee of the exchange concerned, which must determine the fair market price. (Section 44 CISCA). Section 93 of CISCA defines the amounts which may be deducted from the NAV of a portfolio, such as various charges and fees.

Schedule 1 of CISCA requires the deed of a CIS in securities to contain, among other issues, provisions on the manner in which the assets of a portfolio are to be valued for purposes of calculating the selling and repurchase prices of participatory interests, the frequency of their calculation, and the point in time at which such calculations will be performed on a specific day (the valuation point). If assets other than securities listed on an exchange may be included in any portfolio, the deed has to include the basis on which the market value of such assets is to be determined for the purposes of determining selling and repurchase prices. Finally, the deed has to describe the manner in which and the point in time at which the valuation point will be applied either to the creation, sale, repurchase or cancellation of participatory interests. Section 27 of the standard deed for CIS in securities provides that the NAV of a participatory interest is calculated by dividing the aggregate market value of assets and income accruals by the total number of participatory interests

Board Notice 80 requires that any securities that are not listed on an exchange must be valued daily based on a generally recognized methodology and by a person acceptable to the trustee. It further notes that the value of a participatory interest held by one portfolio in another must be calculated by reference to the lower of the repurchase price or the NAV of the relevant participatory interest, at the latest available price before a repurchase price is calculated, or the market value in the case of ETFs.

The deed of a CIS in property must describe the frequency and basis on which the assets of a portfolio are to be valued. Sections 10-12 of the standard deed for CIS in property includes detailed requirements on the valuation of CIS in property.

Under Section 70 of CISCA, a trustee is required to ensure that the selling or repurchase price of participatory interests is calculated in accordance with CISCA and the deed. A trustee is required to enquire into and prepare a report on the administration of the CIS by the manager during each annual accounting period that must state whether the CIS has been administered in accordance with the CISCA limitations on the manager's investment and borrowing powers, the other CISCA provisions and the deed. If the manager does not comply with such limitations and provisions, the trustee must state the reason for the non-compliance and outline the steps taken by the manager to rectify the situation. The report must be sent to the Registrar and to the manager in good time to enable the manager to include a copy of the report in its annual report. (Section 70 CISCA).

Section 74 of CISCA covers general requirements on the maintenance of accounting records and audit. A manager must maintain the accounting records and prepare the annual financial statements for every CIS it administers in conformity with the generally

	<p>accepted accounting practice. Such records and annual financial statements have to be audited not later than three months after the financial year end (or such later date as the Registrar may allow). The auditor must examine the accounting records and annual financial statements and ensure that the accounting records comply with the requirements of CISCA, that the financial statements are properly drawn up so as to fairly represent the financial position, and that the results of the operations of every CIS portfolio are in accordance with the generally accepted accounting practice and the manner required by CISCA.</p> <p>There are no specific requirements for the calculation of the NAV on a regular basis. The standard deed (paragraph 27) provides that the last valuation point determined by the manager may not be more than 24 hours prior to or after the valuation date. However, it does not require that every weekday is a valuation date. ASISA has issued the Standard on Calculation of NAV for CIS Portfolios, which includes some additional requirements. However, ASISA standards are addressed only to its members, they are non-binding and compliance with them is not monitored or enforced by ASISA or the FSB.</p> <p><i>Money market funds</i></p> <p>According to Board Notice 80 of 2012, money market and short-term debt portfolios are portfolios consisting solely of South African rand denominated money market instruments whose participatory interests are at all times valued at a constant price. At the time of inclusion in a money market portfolio, a money market instrument cannot have a residual maturity exceeding 13 months. The weighted average legal maturity<sup>42</sup> of money market instruments included in a money market portfolio may not exceed 120 days. The weighted average duration<sup>43</sup> of money market instruments included in the portfolio cannot exceed 90 days. A manager is required to perform a mark-to-market valuation of the MMF portfolio and each participatory interest every six months to determine the variance of the mark-to-market value with the constant price and report this calculation to the registrar within 30 days of performing the calculation.</p> <p><b>Subscription and redemption</b></p> <p>The basic rule in Section 94 of CISCA provides that a manager may not sell any participatory interest at a price that exceeds or is less than the NAV of that participatory interest. The deed has to include information on the calculation of the selling and repurchase prices (see above). In addition, Schedule 1, paragraph 2 of CISCA requires the deed to provide for the following in respect of the repurchase of</p>
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<sup>42</sup> Weighted average legal maturity means the weighted average of the remaining life of each instrument held in a portfolio, meaning the time remaining until the principal value is repaid in full.

<sup>43</sup> Weighted average duration means a measure of the average length of time to maturity of all the underlying instruments in the portfolio, where the duration of a floating rate instrument is the time remaining until the next interest rate reset to the money market rate.

	<p>participatory interests in a portfolio of a CIS in securities:</p> <ul style="list-style-type: none"> <li>• That it is the obligation of the manager to repurchase any number of participatory interests offered to it;</li> <li>• That the manager must determine a point in time by when repurchase requests must be received for the purpose of determining which valuation point will be utilized for the pricing calculation (which may not be changed unless 30 days' prior written notice has been given to investors);</li> <li>• That a manager may in circumstances determined by the Registrar under Section 114(3)(f) of CISCAs (see below), with the prior consent of the trustee, suspend the repurchase of participatory interests;</li> <li>• That a manager must in circumstances determined by the Registrar under Section 114(3)(f) of CISCAs, if the trustee so requires, without delay suspend the repurchase of participatory interests, if the manager or trustee is of the opinion that the circumstances warrant the suspension in the interest of investors; and</li> <li>• That the repurchase of such participatory interests must be settled in accordance with the conditions determined by the Registrar under Section 114(3)(f) of CISCAs.</li> </ul> <p>One of the duties of a trustee or custodian under Section 70 of CISCAs is to ensure that the basis on which the sale, issue, repurchase or cancellation of participatory interests effected by or on behalf of a CIS is carried out in accordance with CISCAs and the deed and that the selling or repurchase price of participatory interests is calculated in accordance with CISCAs and the deed.</p> <p>There is no regulatory requirement for the price of the CIS to be disclosed or published on a regular basis to investors or prospective investors. However, the industry has developed a practice of daily publication of prices in the print media.</p> <p><b>Pricing errors</b></p> <p>There are no regulatory requirements addressing pricing errors. An ASISA standard<sup>44</sup> includes general principles on dealing with pricing errors and determining their materiality for the purposes of defining whether compensation should be provided. According to the FSB, the CIS managers report all pricing errors and a plan on how they will be resolved to the Registrar, who assesses all the reported pricing errors. If he/she believes that the interests of the investors are prejudiced, the Registrar directs the CIS manager on steps to take.</p>
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<sup>44</sup> Net Asset Value Calculation for CIS Portfolios—Principles and Practices (that at the time of the assessment mission was pending ratification by the ASISA Board).

	<p><b>Suspension of pricing and redemptions</b></p> <p>Section 114(3)(f) of CISCAs provides that the Registrar may by notice in the Gazette determine the circumstances under which the manager of a CIS in securities may suspend the repurchase of participatory interests and the conditions of such suspension, provided that any offer of participatory interests for repurchase by an investor, the aggregate amount or value of which does not exceed the amount specified by the Registrar, on the day of such offer, is excluded from any suspension.</p> <p>Notice 573 of 2003 (Suspension of Repurchase of Participatory Interests by Manager of CIS in Securities) provides more detailed requirements on this. The basic rule is that, with the consent of the trustee, the manager may suspend the repurchase of participatory interests, if the aggregate amount of offers for repurchase exceeds five percent of the market value of a portfolio as at the last valuation point. This condition does not however preclude a manager from entering into an agreement with an investor determining a more restrictive basis on which repurchase offers will be honored.</p> <p>This right is further limited by the conditions stipulated in Notice 573 (the deed may also include more restrictive conditions). They provide that the repurchase of participatory interests, irrespective of their aggregate amount or value, may not be suspended if ten business days' valid notice of the offer for repurchase has been given to the manager. Further, the repurchase of participatory interests offered for repurchase by an investor, the aggregate amount or value of which does not exceed ZAR 50,000 on the day of such offer, may not be suspended.</p> <p>If a manager decides to suspend the repurchase of participatory interests under the above circumstances, it must forthwith and with the consent of the trustee, segregate a portion of the assets, equivalent to the value of all received offers for repurchase, from the rest of the assets in the portfolio. The manager must forthwith notify the investor(s) concerned that repurchasing has been suspended, in which case the investor must be given the option to withdraw its offer to repurchase on the day of such notification or to accept assets equivalent in value to the offer for repurchase. The manager must also forthwith notify the investor(s) concerned that it will endeavor to honor the repurchase request within 20 business days from the date of suspension. It must calculate, and communicate to the investor(s) on a daily basis, a single price per participatory interest based on the segregated assets. If the manager fails to meet the offer to repurchase participatory interests within 20 business days, it must tender assets to that investor for payment, except if the investor consents to an extension of 20 business days to enable the manager to liquidate the relevant assets.</p> <p>The manager must forthwith notify the Registrar of the suspension of repurchasing, the reasons for it and how it will be dealt with.</p>
Assessment	Not Implemented

Comments	<p>The regulatory requirements on the valuation of CIS in securities are very general, and there are no requirements on the accounting standards to be used to calculate the NAV of a CIS. A fair market price can be determined by one member of the JSE, independent of the security in question. There is a need to significantly enhance the regulatory requirements on the valuation of CIS assets and determine the high quality accounting standards to be used in such valuations to comply with Key Questions 1, 2(b), 3 and 6 of the IOSCO Assessment Methodology.</p> <p>MMFs use amortized cost to value their investments and apply a constant NAV for subscriptions and redemptions. The South African model is not fully in line with IOSCO Policy Recommendations for Money Market Funds.<sup>45</sup> The authorities should consider whether South African money markets funds could be converted to floating/variable NAV funds, as recommended by IOSCO. Alternatively, the authorities should introduce appropriate additional safeguards as recommended by IOSCO.</p> <p>Trustees play a significant role in ensuring the fairness and reliability of valuations. As noted in Principle 24, the Registrar should take this into account in planning its on-site visit program.</p> <p>There are no regulatory requirements on disclosing the CIS unit prices and the frequency of calculating the NAV of a CIS. There are no regulatory requirements on the treatment of pricing errors. Even though the industry may comply with the ASISA standard, it is important to ensure that there is sufficient legal backing to enable the FSB to enforce these important requirements.</p>
<b>Principle 28.</b>	Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.
Description	<p><b>Regulatory requirements for hedge funds</b></p> <p>The FSB Board Notice 79 of 2003 (Codes of Conduct for Administrative and Discretionary FSPs, as amended) includes a definition of hedge fund, according to which a hedge fund means a portfolio that uses any strategy or takes any position that could result in the portfolio incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include but are not limited to leverage or net short positions. Despite the existence of this definition, there are currently no regulatory requirements for the hedge funds themselves. Instead the definition is used to define a category of FSPs (hedge fund FSPs) subject to regulation (see below and in Principles 29-31).</p>

<sup>45</sup> This applies to, for example, maximum residual maturity of a money market instrument, which IOSCO recommends to be 90 days for money market funds that use amortized cost accounting.

	<p><i>Planned future requirements</i></p> <p>The FSB developed a proposed regulatory framework for hedge funds that was published for consultation in September 2012. Following the review of comments, draft regulations were published for public comment in April 2014. At the time of the mission, the FSB was expecting to implement the new hedge fund regulations during the final quarter of 2014.</p> <p>The new framework proposes to regulate hedge funds as CIS under CISCA. Hedge funds would accordingly have to comply with CISCA requirements applicable to CIS. There would be two types of hedge funds (retail and restricted) depending on the types of investors they would have. Only qualified/sophisticated investors would be permitted to invest in the restricted hedge funds. Foreign hedge funds could also be approved to solicit investments in South Africa, once the new regulations would have been implemented.</p> <p><b>Requirements for authorization as a hedge fund manager</b></p> <p>The above mentioned FSB Board Notice 89 defines a hedge fund FSP as a financial services provider that renders intermediary services of a discretionary nature in relation to a particular hedge fund or fund of hedge funds in connection with financial products defined in Sections 1(a)-(e) of the FAIS Act, acting for that purpose specifically in accordance with the provisions of the specified codes, read with the FAIS Act, the General Code of Conduct for Authorized Financial Services Providers, 2002 (where applicable), and any other applicable law.</p> <p>Hedge fund managers currently have to be authorized as Category IIA FSPs under the FAIS Act. They also must have a Category II license (see Principle 29). The requirements for the application process and content of the standard application for an FSP license are described in Principle 29. Different fitness requirements apply for different categories of FSPs.</p> <p>The FSB Board Notice 88 (Application by Financial Services Providers for Authorization by the Financial Services Board Amendment Determination, 2007) includes the specific requirements for the content of the application for approval as a Category IIA FSP (Form FSP 15):</p> <ul style="list-style-type: none"> <li>• Relevant completed forms for each key individual, including the key individual's experience in the management of hedge fund portfolios;</li> <li>• Operational ability of the FSP relating to the hedge fund FSP application (Form FSP 15B);</li> <li>• Details of the types of clients for whom the FSP manages hedge fund assets or portfolios, as well as the total market value and the percentages of hedge fund assets managed for each category of client (based on the most recent portfolio valuations available). If the information relating to the underlying clients and/or hedge funds is not available to the applicant, reasons as to why such</li> </ul>
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information cannot be submitted. (Form FSP 15C).

- A copy of all specimen mandates relating to the management of hedge fund clients;
- Latest audited financial statements of the FSP, and if they are older than three months, latest financial management accounts;
- Description of the risk management processes employed in respect of the FSP's hedge fund management business (as required in Part IX of the General Code of Conduct for Authorized Financial Services Providers and Representatives, 2003); and
- Personal details, qualifications and experience of the person(s) responsible for the risk management, administration and valuation of hedge fund portfolios (if the function is outsourced, full details of the entity to which it is outsourced and the details of the responsible persons).

It is currently not possible for a foreign hedge fund manager to manage South African hedge funds. Instead they can only be granted a Category I license in South Africa, and the management of hedge funds is considered to take place abroad.

#### **Operational conduct and conflicts of interest**

The current requirements for the risk management, protection and segregation of client assets and management of conflicts of interest by all FSPs, including hedge fund managers, are described in Principle 31.

#### *Planned future requirements*

The hedge fund regulations are intended to introduce specific risk management requirements applicable to hedge fund managers. A hedge fund manager would be required to have a risk management program in place setting out the types of derivatives the hedge fund will use, the risks associated with the derivatives and how those risks will be managed. The risk management program would also be required to provide information on the trading process and leverage applied.

The intention is to require hedge fund assets to be subject to independent valuation. All listed investments would be required to be priced according to market prices, while unlisted investments would have to be priced according to a methodology approved by the trustee and undertaken by a party approved by the trustee.

#### **Prudential requirements**

The general accounting and audit requirements applicable to all FSPs apply to hedge fund managers (see Principle 30). In addition, Part IX, Section 9 of Board Notice 106 (Determination of Fit and Proper Requirements for Financial Services Providers, 2008) includes the specific financial soundness requirements for category IIA FSPs. A Category IIA FSP must at all times comply with the following requirements:

- The assets of the FSP (excluding goodwill, other intangible assets and investments in related parties) must exceed the FSP's liabilities (excluding loans validly subordinated in favor of all other creditors) by at least ZAR 3 million;
- The FSP must maintain current assets which are at least sufficient to meet current liabilities; and
- The FSP must at all times maintain liquid assets equal to or greater than 13/52 weeks of annual expenditure.

*Planned future requirements*

In addition to a capital requirement applicable to hedge fund managers, it is intended that they would be required to report monthly to the Registrar on the gross assets, net assets, short positions and leveraging of the hedge funds. They would also be required to identify the credit counterparties of the hedge funds, report quarterly on the holdings of the hedge funds and submit annual reports to the Registrar.

**Disclosure to investors**

Board Notice 571 (Hedge Fund FSP Risk Disclosures, 2008) requires hedge fund FSPs to disclose in writing to clients the risks and other characteristics of hedge funds as provided for in the schedule of the Notice. The disclosures in the schedule do not cover all risks that may arise from investing in a particular hedge fund portfolio. A hedge fund FSP must therefore augment these disclosures by describing all other risks and hedge fund characteristics that are identified and peculiar to a specific hedge fund portfolio. Hedge fund FSPs must ensure that clients understand the risk disclosures.

A hedge fund manager must furnish a written report to a client on request and at regular intervals which cannot exceed three months at a time. A report must include information that enables the client to determine the composition of the financial products comprising the investment and the changes in them as well as the market value of the financial products comprising the investment over the reporting period. Section 6.3 of the Codes of Conduct for Administrative and Discretionary FSPs includes additional requirements on the content of the report.

*Planned future requirements*

It is intended to require hedge fund managers to comply with the initial and ongoing disclosure requirements of Sections 3 and 100 of CISCA. The hedge fund manager would be expected to prepare a key investor information document, which would assist investors' understanding of the investments being offered. Hedge funds would be required to provide information pertaining to valuation methodology, positions and leverage exposure. Other information would include the name of the trustee, information about the fund, copies of its prospectus, annual reports and other practical information. The key investor information documents would also have to incorporate a risk and reward indicator indicating the levels of risk together with a narrative explanation of the risk.

### **Reporting, supervision and enforcement**

There are currently no regular reporting requirements for hedge fund managers beyond the reporting requirements imposed on them as FSPs (see Principles 30 and 31). If there are concerns or complaints about a hedge fund manager, information can be requested under Section 4(2) of the FAIS Act. The power of the Registrar to conduct on-site visits and instruct an inspector to conduct an inspection is provided in Section 4(5) of the FAIS Act (see Principle 10).

According to the FSB, all hedge fund managers are subject to on-site visits at least once every two years. High risk category hedge fund managers are visited every year. Between January 2011 and March 2014, the FSB conducted 88 on-site visits of hedge fund managers. A full on-site visit covers the same topics as any FSP on-site visit (see Principle 31). In addition, an on-site visit of a hedge fund manager covers the following topics:

- Hedge fund investment approach and due diligence on the selection of funds and fund managers;
- The controls over assets under management;
- The relationship with the administrator, the independence of the administrator, the due diligence conducted on the systems and controls of the administrator, the accuracy of reports and ability to provide management information;
- The fee structure, disclosures and calculations;
- Mandate compliance and mandate monitoring; and
- Compliance monitoring by a hedge fund's compliance officer and its effectiveness.

The various functional and support areas of a hedge fund manager are reviewed during the on-site visits to determine the existence of policies, procedures and controls, whether they have been implemented, the adequacy of control measures and the level of adherence to the set policies, procedures and controls.

A risk-based methodology approach is adopted when conducting the on-site visits at hedge fund managers. The various risks, the control measures and their adequacy are identified and discussed. Firms are required to adopt an enterprise-wide risk management approach and to maintain a comprehensive risk management framework. The compliance function and its independence and adequacy are also assessed during the on-site visit. The valuation of investments and valuation methodologies is tested, especially if this function has not been outsourced to an external third party administrator. Focus is also placed on the valuation of OTC products.

Contraventions of the FAIS Act by a hedge fund manager can be referred to the EC under the Protection of Funds Act. There have not been any enforcement cases against

	<p>hedge fund managers.</p> <p><b>Cooperation and exchange of information</b></p> <p>The FSB's power to collect information on behalf of a foreign Regulator is described in Principle 15. Its information sharing powers and arrangements are described in Principle 14.</p>
Assessment	Fully Implemented
Comments	<p>This assessment is based on the current regulatory framework. The information on the planned future framework is included only for information/comparison and has not been assessed for compliance with Principle 28.</p> <p>South African legislation currently requires the asset manager rather than the operator (CIS manager) of a hedge fund to be registered. This complies with the requirements of the IOSCO Assessment Methodology. Since hedge fund managers are currently regulated under the FAIS Act rather than CISCA, the regulatory framework effectively complies with Principle 28 (see the assessment of Principles 29 and 31).</p>
<b>Principles for Market Intermediaries</b>	
<b>Principle 29.</b>	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>The FSB and JSE share responsibility for initial licensing and on-going supervision of market intermediaries in South Africa. Sections 7 and 8 of the FAIS Act require persons who furnish advice or render intermediary services to be licensed by the FSB. JSE members are approved by the JSE and are exempt from licensing under the FAIS Act for the activities carried on as members of the exchange.</p> <p><b>Categories</b></p> <p><i>FAIS Act</i></p> <p>The five licensing categories for FSPs under the FAIS Act are set out in the Fit and Proper Notice. Only the first four relate to securities activities.</p> <ul style="list-style-type: none"> <li>• Category I – an FSP that renders financial services other than the financial services mentioned in Categories II, IIA, III and IV. The giving of advice and rendering intermediary services in respect of each category of products are licensed separately.</li> <li>• Category II (Discretionary FSP) – an FSP that renders intermediary services of a discretionary nature regarding the choice of a particular financial product referred to in the definition of administrative FSP but without implementing any bulking. This is discretionary portfolio management for specific clients.</li> <li>• Category IIA (Hedge Fund FSP) – an FSP that renders discretionary or non-discretionary intermediary services in relation to a particular hedge fund or</li> </ul>

fund of hedge funds in connection with a particular financial product referred to in the definition of administrative FSP. A Hedge Fund FSP must also apply for a Category II license.

- Category III (Administrative FSP) - an FSP that renders intermediary services in respect of specified financial products, on the instructions of a client or another FSP and through the method of bulking. These are also referred to as Linked Investment Service Providers (LISPs) or investment platforms.
- Category IV (Assistance Business FSP) - an FSP that renders intermediary services in relation to the administration of assistance policies on behalf of an insurer to the extent agreed to in terms of a written mandate between the insurer and the Assistance Business FSP.

FSPs can either be incorporated/organized entities (companies, trusts or partnerships) or individuals (sole proprietorships), although Category III FSPs are generally required to be companies.

Approvals are granted on a per service/product basis and any new activity or product requires a specific approval. FSPs may be required to be registered in more than one category. All of Categories I to III can buy or sell securities for their own account; that is, they can engage in proprietary trading. Only Category I FSPs can give advice.

Individuals acting as representatives of FSPs are not directly licensed by the FSB. If the FSP acts through individual representatives, the representatives must meet the fit and proper requirements set out in the Fit and Proper Notice. The FSP must ensure they continue to meet these requirements and must take responsibility for their actions under section 13 of the FAIS Act. The FSB is notified of who has been appointed as a representative and keeps a central register (available to the public) of such appointments. It is also notified of any terminations of these persons. The FSB can, however, take action directly to bar individuals who are judged not to be fit and proper.

#### *JSE*

The JSE licenses and oversees its licensed members (called authorized users under the FMA). These entities are not required to be licensed under the FAIS Act unless they provide additional financial services not regulated by the JSE. Under the Equities Rules, the dominant business activity of a member must be the performance of regulated services in respect of JSE authorized investments. The scope of a member's business activities may also include the management of investments or provision of advice in relation to other financial products, subject to the member having been granted the appropriate license to conduct such activity under the FAIS Act (Rule 3.30.2.1). These 'other activities' may not include acting as an FSP with respect to insurance contracts, or pension, friendly society or health service benefits (Rule 3.40).

The JSE has three different categories of membership:

- Trading Service Provider (TSP): A TSP is authorized to perform trading services on behalf of its clients or for its own account.
- Custody Service Provider (CSP): A CSP is authorized to perform custody services on behalf of its clients or other members and their clients.
- Investment Service Provider (ISP): A member may apply to perform investment services only if it has applied to perform trading services also. Investment services include:
  - Exercising the discretion of the management of JSE authorized investments on behalf of clients;
  - Providing investment advice to a client in respect of JSE authorized investments;
  - Safeguarding JSE authorized investments (other than uncertified equity securities) and funds intended for the purchase of equity securities.

There are also specific requirements to be met by a member to be approved under the Equities Rules, the IRC Rules and the Derivatives Rules in order to trade in those instruments.

#### *Banks and other financial institutions*

Banks and other financial institutions may conduct securities and derivatives activities. In some cases, these activities can be provided by the financial institution directly, but it must be licensed for these activities under the FAIS Act and is subject to supervision by the FAIS Division of the FSB with respect to those activities. If the financial institution wishes to trade in authorized investments on the JSE equities market, it must establish a separately capitalized subsidiary, which must meet all the usual rules of the JSE for membership. If the financial institution wishes to engage in the management of CIS, this activity also must be done through a separate subsidiary the activities of which are limited to CIS management. Derivatives trading on the JSE derivatives market or OTC may be done by a bank directly.

A temporary exemption has been issued to permit banks to carry on merchant banking activities without licensing under the FAIS Act, provided they only deliver these services to particular types of sophisticated clients (other financial institutions, regulated entities such as FSPs, asset managers with substantial assets under management, central banks and high net worth companies). The exemption is not available, if the client is a natural person (no matter how wealthy) or a pension fund. A code of conduct to govern these activities is in development by the FSB. When the code is final, this exemption from licensing will be withdrawn.

#### **Licensing process and requirements**

##### *FAIS*

Under section 8 of the FAIS Act, all applicants must meet the "fit and proper"

requirements set by the Registrar regarding:

- Personal qualities of honesty and integrity;
- Competence (experience, qualifications and regulatory examinations);
- Operational ability; and
- Financial soundness.

The first three requirements also apply to key individuals of the FSP – defined in the FAIS Act as those persons that are responsible for managing or overseeing the firm’s activities relating to the rendering of any financial service - and the compliance officer (sections 8(2) and 6A FAIS Act). In addition, these individuals may be subject to continuing education requirements. The FSP must ensure the representatives acting for the firm meet the same fit and proper standards (section 13(2) FAIS Act). Also, anyone holding more than 25 percent of the shares of the applicant firm is subject to an assessment to ensure they are suitable. Each of these individuals is required to submit a detailed information form as part of the application process (see FSP Forms 3 – 6). The competence requirements are tailored to the type of services and products to be offered. In particular, the courses that must be passed and the length of prior experience required vary by product and service.

The details of the categories of firms and fit and proper requirements applicable to each category are set out in the Fit and Proper Notice.

There is an application process set out by Board Notice 60 of 2009 that requires the submission of specified forms relating to particular matters, including, general business information; directors, officers and substantial shareholders (over 25 percent); representatives; the compliance officer; the firm’s operational ability; financial soundness; and its external auditor. In practice, all applicants are expected to provide a copy of their business plan.

Part IX of the Fit and Proper Notice sets out initial capital requirements that must be met by FSP applicants. These initial capital requirements must be maintained at all times by FSPs. Applicants that are applying for licensing in multiple categories must meet the highest requirements. See the discussion in Principle 30.

All FSPs are required to provide specific information at the application stage regarding their internal organizational, risk management, and supervisory systems. The Fit and Proper Notice requires that FSPs have and are able to maintain the operational ability to fulfill the responsibilities imposed by the FAIS Act on authorized FSPs including:

- A fixed business address;
- Adequate access to communication facilities;
- Adequate systems for the safekeeping of records and business communications,

- A bank account;
- Policies, procedures and systems to comply with FICA and other applicable anti-money laundering or terrorist financing legislation;
- The internal controls structure, and procedures required to ensure:
  - Appropriate segregation of duties, roles and responsibilities from an operational risk mitigation perspective;
  - Access controls that are in place to ensure physical and data security;
  - Documented policies and procedures;
  - Disaster recovery and electronic data back-up procedures to ensure business continuity; and
- Guarantees, professional indemnity or fidelity insurance cover in respect of the clients of the provider or representatives.

General information is required and FSPs must confirm that all requirements in relation to each of the criteria are met. While the application form relating to financial soundness requires detailed financial statements to be attached, the form on operational capacity consists of a list of questions asking about aspects of the firm's operational controls and related arrangements as are required by the Fit and Proper Notice in Part VIII. Only yes/no answers are required. No additional details are required to be filed with the application by applicants for licensing in Category I. Applicants in Category II, IIA and III must provide evidence that they meet the standards (copies of manuals etc.). These are verified by on-site reviews before the firms are licensed. See also the discussion in Principle 31.

As part of the operational ability requirements, specific requirements apply where the FSP is outsourcing substantial activities. The FSP must provide specific information regarding what these outsourced functions entail, whether the outsourced entity is an approved FSP, the name of the outsourced entity and whether the entity is an independent party, a related party or both. Further, the FSP must confirm that it has a process in place to ensure that only suitable providers are selected for outsourced function(s) and that a written service level agreement is in place that complies with the requirements.

Apart from the general requirements listed above, Category IIA and III firms (hedge fund managers and administrative FSPs) are required to meet additional, very specific requirements relating to the form and contents of the mandates (discretionary client contracts) that may be used with their clients. These mandates must be submitted for approval at the time of application (Codes of Conduct for Administrative and Discretionary FSPs, Board Notice 79 of 2003). Where nominee companies are used to register clients' assets, the nominee company must have prior approval under the FSB's nominee policy.

The FAIS Division follows a systematic process in reviewing each application. On-site visits are conducted at applicants for Category II, IIA and III licenses prior to the licenses being granted to verify the information supplied in the application. Further, prior to final approval on behalf of the Registrar, the Licensing Committee of the FSB reviews the application to ensure that fair and consistent standards are met. If there are concerns, the Committee makes recommendations to the Division. These are not binding on the Division but are given due weight.

#### *JSE*

The JSE Rules contain detailed requirements that applicants for membership must meet under the Equities Rules (chiefly in sections 3 and 4), Derivatives Rules (in section 3) and IRC Rules (section 3). These address all of fit and proper requirements, operational capacities and financial requirements, among other things.

JSE Equities Rule 3.30 sets out the financial resource requirements that are binding on all members at the time of admittance and on an ongoing basis. This rule specifies that adjusted liquid capital must be held by members at all times and refers to Equities Directive DC that describes how the base and risk capital requirements must be calculated. The base amount is determined by the higher of the prescribed minimum amount or operating expenses over a specified period (thirteen weeks). The risk requirement is determined by the sum of the amounts required to cover the different risks undertaken. See the discussion in Principle 30.

All firms that make use of a JSE trading system and have settlement obligations in a JSE market generally must meet the same standards in relation to those matters. However, under the Derivatives Rules, banks are exempted from the requirement to file monthly capital adequacy reports (Rule 3.70.5).

The JSE undertakes a comprehensive assessment of an applicant for membership to ensure the applicant meets all of the membership requirements and will be able to meet its ongoing compliance obligations. For example, under the Equities Rules:

- Section 4 deals broadly with the management and control of authorized users. Rule 4.10 (Fit and proper requirements) specifies the assessment undertaken by the JSE of persons who hold in excess of 10 percent of the issued shares of the member as well as officers and non-executive directors of the member.
- Rule 4.60.1 requires the primary place of business of a member to be under the control of a stockbroker. A stockbroker is a qualified professional who has evidenced knowledge of all of the important aspects of stockbroking.
- Rule 3.30 (Specific conditions of membership) specifies that adequate resources, procedures and systems must be employed by members for the effective performance of the regulated services that they provide and states that the employees of the member must be suitable, adequately trained and properly supervised.

- Rule 4.70 requires a firm to have in place resources, procedures and technological systems necessary for the effective conduct of its business, including systems of consumer protection, internal control and risk management that meet specified objectives. For example, under Rule 4.70.4 the risk management system 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:
  - Identify, quantify, control and manage the risk exposures of the member;
  - Make timely and informed business decisions;
  - Monitor the performance and all aspects of the business of the member;
  - Monitor the capital of the member to ensure compliance with the capital adequacy requirements imposed under the rules; and
  - Monitor the quality of the member's assets.

A member must be able to describe and demonstrate the objectives and operation of these systems, principles and procedures to its auditor and to the JSE.

Applicants must file extensive materials with their applications, including policy and procedure manuals relating to risk management and internal controls, fit and proper questionnaires for personnel, etc. The information that must be provided depends upon the category of membership applied for with CSPs in particular required to provide very extensive and detailed materials. The JSE does not routinely do on-site reviews before membership is granted, but CSPs would be visited within their first year of operation.

There are additional requirements that apply based on the services that the member intends to offer, such as the requirement for an approved nominee, if the member intends to hold client assets (Rule 3.50.3.2). There are also specific requirements for segregation of duties based on the activities of the firm. For example, JSE Equities Directive DN (Production and distribution of client statements) states at DN 5 that there must be appropriate segregation of duties between persons responsible for the production and distribution of client statements and persons involved in transactions on client accounts, as well as the persons who control the record of addresses to which the client statements are sent.

The FSB is in the process of finalizing a Code of Conduct under the FMA that would apply to authorized users (JSE members), which would contain similar requirements on internal controls and risk management to those set out in the JSE Rules and those that presently apply to FSPs. This would give the FSB direct authority to take action against JSE members for breaches of the requirements set out in the code, rather than having to act indirectly through the JSE.

**Licensing authority**

The Registrar may grant an FSP license, if the Registrar is satisfied that the applicant, its key individuals and compliance officer comply with the requirements of the FAIS Act (section 8(3)). The Registrar may refuse the application if the Registrar is not so satisfied. The license may be granted subject to terms, conditions and restrictions as are appropriate and the Registrar is granted wide authority with respect to what conditions may be imposed (section 8(4)). The FAIS Division has a number of standard conditions that are imposed on all licenses, including the obligation to report any material change at the firm within 15 days.

The Registrar also has authority under the FAIS Act to suspend a registration or withdraw it, if he/she is satisfied that the conditions set out in section 9 are met. These include circumstances where the licensee does not meet the applicable fit and proper requirements, or has failed to comply with:

- Any other provision of the Act;
- Any directive issued under the Act; or
- Any condition or term attached to the license or imposed under the Act (section 9(1)).

The licensee must be given notice of the reasons for the proposed action and a right to respond (section 9(2)).

See the comments above regarding the regulation of representatives. The FSB has authority to take action directly to bar individual representatives who are judged not to be fit and proper.

Under the JSE Rules, the exchange has the sole discretion to accept or reject an application for membership or grant membership subject to conditions (Equities Rule 3.100.3). It can suspend a member, revoke the approval of a member, impose terms and conditions or impose fines for the contravention by a member of any of the rules or directives of the exchange. See Equities Rules 12.40 to 12.60 that address the JSE's disciplinary procedures.

All persons designated as officers are required to meet the fit and proper requirements in Rule 4.10 in order to be registered by the JSE to fulfill the relevant functions. Similar requirements apply to anyone holding 10 percent or more of the shares of a member firm. The fit and proper requirements are extensive and disqualify the insolvent; those found liable for criminal or civil breaches involving fraud, theft or dishonesty; and those previously expelled from or declared a defaulter on any exchange, among other criteria (section 4.10). Rule 4.20 prohibits the member from employing in any capacity anyone who has been refused approval to act as an FSP or a representative of an FSP; expelled as a member or was an officer of a member that was expelled from any exchange; or has been convicted of a fidelity offence.

**Periodic updates**

Under the FAIS Act, once a license is granted, the intermediary is subject to on-going reporting requirements under the legislation and its licensing conditions. Under condition 2.1 of the standard conditions and restrictions imposed on authorized FSPs as permitted by section 8(4) of the FAIS Act, the FSP is required to inform the Registrar of any change in respect of the business information of such FSP that was submitted by the FSP for purposes of obtaining a license. In particular, notice must be given relating to changes in the FSP's shareholders, directors, representatives, auditor, compliance officer, foreign clearing firm or foreign exchange service provider, nominee company or independent custodian. Notices must be in writing and be delivered within 15 days of the change.

Under section 8A(1) of the FAIS Act, all authorized FSPs, key individuals and representatives of the FSP must continue to comply with all applicable fit and proper requirements at all times. If at any time it appears that a person does not meet these requirements, the Registrar may suspend or withdraw any license (section 9).

The Rules of the JSE require a member to give the JSE immediate written notice of:

- Any change in the name of the member or address of any office of the member, and of any change in the member's telephone or facsimile numbers or electronic mailing addresses; the granting of an application for, or the revocation of, any registration, authorization or license which may bear upon or be associated with its business as a member of the JSE;
- The prosecution or conviction of the member for any offence under legislation relating to banking, other financial services, companies, insolvency, insurance and pension and provident societies, or for any offence involving fraud or dishonesty;
- Any change to the appointment of a compliance officer, a settlement officer or an alternate settlement officer or any person becoming or ceasing to be a director of a member;
- Any person ceasing to be a registered securities trader of a member;
- Any change to the appointment of a person in control of a place of business of a member;
- Any change in the name of a nominee company maintained or the use of a new or different nominee company; and
- Any event or circumstance which has or may have any bearing on whether an officer or a shareholder who is a natural person and who directly or indirectly holds in excess of 10 percent of the issued shares of the member, fails to meet the fit and proper requirements (Rule 3.150).

All requirements for membership must be in place on application and continue to be

	<p>met thereafter (Rule 3.20). Any failure to continue to meet these requirements render the member subject to disciplinary action and may lead to the withdrawal of membership.</p> <p><b>Publicly available information</b></p> <p>Once the license is granted, the FSP must:</p> <ul style="list-style-type: none"> <li>• Display a certified copy of the license in all business premises of the FSP;</li> <li>• Ensure that a reference to the fact that such a license is held is contained in all business documentation, advertisements and other promotional material;</li> <li>• Ensure that the license is available for production, immediately or within a reasonable time, to any person requesting proof of licensed status.</li> </ul> <p>In addition, the FSB's website contains a portal through which the public may conduct a search on a licensee using the licensee's name or license number. The search will reveal information about the licensee's status, products authorized, and persons authorized to act on its behalf as representatives and key individuals.</p> <p>Information on exchange members is published on the website of the exchange. The information includes the member's name, contact details (postal address, website address and telephone/fax numbers) and the type of approval granted to the member. The site does not include the names of officers, directors or authorized representatives.</p> <p><b>Regulatory treatment of advisers</b></p> <p>Advising is not subject to a special regime in South Africa. Firms that act on behalf of clients or hold client securities are subject to similar rules with respect to capital, internal controls, record-keeping etc., whether or not they engage in giving advice. The regime in the JSE Rules does not impose lesser standards on advisers than on other members.</p> <p>See the discussion above and under Principles 30 and 31.</p>
Assessment	Fully Implemented
Comments	The member information contained on the JSE website should be extended to include the names of the key officers of each firm.
<b>Principle 30.</b>	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p><b>Capital requirements</b></p> <p>FSPs need to meet initial capital adequacy requirements based on the category of license of the FSP. These initial requirements must be maintained. Certain FSPs only have to meet on-going solvency requirements (Fit and Proper Notice Part IX).</p>

<b>FSP Minimum Capital Requirements</b>				
<b>Minimum capital that must be maintained at all times</b>	<b>Category I (No client assets)</b>	<b>Category I (Hold client assets)</b>	<b>Category II and IV</b>	<b>Category IIA and III</b>
Positive Net Assets (assets* less liabilities**)	Net assets must be greater than zero	Net assets must be greater than zero	Net assets must be greater than zero	Net assets must be greater than ZAR 3 million
Current assets at least equal to current liabilities	Yes	Yes	Yes	Yes
Amount of liquid assets <sup>^</sup>	None	4/52 weeks of annual expenditure <sup>^^</sup>	8/52 weeks of annual expenditure	13/52 weeks of annual expenditure
<p>* Assets excludes good will, intangible assets or investments in and loans to clients and investments in and loans to related parties.</p> <p>** Liabilities excludes loans subordinated in favor of other creditors.</p> <p><sup>^</sup> Liquid assets means cash and other assets equivalent to cash that can be liquidated without realizing a loss on liquidation, provided that 25 percent of such assets must be capable of being liquidated in 7 days; a further 25 percent of such assets must be capable of being liquidated in 30 days; and the remaining 50 percent of such assets must be capable of being liquidated in 60 days.</p> <p><sup>^^</sup> Annual expenditure means the expenditure set out in the latest financial statements of the FSP, less staff bonuses; employees', directors', partners' or members' share in profits; emoluments of directors, members, partners or a sole proprietor; other appropriation of profits to directors, members and partners; 50 percent of the commissions or fees paid to representatives for the rendering of services that did not form part of their remuneration; depreciation; bad debts; and any loss resulting from the sale of assets.</p> <p>The definitions of current assets and current liabilities are the usual accounting ones: assets that can reasonably be expected to be converted into cash within one year in the normal course of business and liabilities that are due to be paid in less than a year.</p> <p>Only Category IIA and III firms are required to have substantial positive net assets. Other than the amount of liquid assets required, the other capital requirements do not change based on the general risk of the firm. The overall requirements are not particularly sensitive to the nature or size of the assets on the FSP's balance sheet. The minimum requirements do not vary whether or not an FSP does proprietary trading.</p> <p>In addition to the capital adequacy requirements, under the Fit and Proper Notice the</p>				

FSP must maintain adequate professional indemnity and fidelity insurance in an amount to cover the risks of losses due to fraud, dishonesty or negligence, subject to specified minimum amounts. The minimum requirements vary between ZAR 1 million and ZAR 5 million. Except for Category II, there is no difference between the coverage required for a firm that holds client assets versus one that does not (Board Notice 123 of 2009). However, in practice, firms are expected to have higher coverage than the minimum and considerably more than the minimum, if they hold client assets. The appropriateness of the coverage is assessed by the FSB during its on-site inspections.

Members of the JSE must comply with initial and ongoing capital requirements, which are imposed by the rules of the exchange and which are similar to the first Capital Adequacy Directive of the European Union.

On application for membership, an applicant must have “adequate financial resources to meet its business commitments and to withstand the risks to which its business is subject” (Equities Rule 3.30.3.1). It must calculate and maintain at least this minimum amount of capital on an on-going basis. The base amount is determined by the higher of the prescribed minimum amount or operating expenses over a specified period. The risk requirement is determined by the sum of the amounts calculated by risk type (such as position, credit, concentration, foreign exchange, and large exposure).

The base amount under the Equities Rules is the greater of 13 weeks fixed expenditure or ZAR 400,000 (Rule 3.30.3.3). The initial capital required under the Derivatives Rules for members is ZAR 200,000 for members who do not hold client margins or assets and ZAR 400,000 for those that do hold client margins or assets; clearing members must have own funds of ZAR 200 million (Derivatives Rules 4.20.6 – 4.20.7). The IRC Rules mirror the Derivatives Rules’ requirements (Rule 3.40). The JSE noted that the amount of capital required to meet the fixed expenditure requirement was always substantially larger than the fixed amount of ZAR 200,000 to 400,000 for non-clearing members.

The detailed capital calculation is set out in the JSE directives. Equities Directive DC contains detailed requirements with respect to the calculation of a member’s financial resources. The required formulae to be followed in calculating the amount for each risk category are also set out there. The market risk calculations by type of instrument appear in DC3 – DC7 (Position Risk Requirements (PRR)); credit risk calculations in DC9 (Counterparty Risk Requirement (CRR)); Foreign Exchange Requirement in DC10; and Large Exposure Requirement in DC11. As under the EU Capital Adequacy Directive, the amounts required are calculated based on the market value of the relevant assets multiplied by a specified percentage (weighting) that varies based on the type of asset. Operational risks are calculated in accordance with DC12 (Fixed Expenditure Base Requirement (FEBR)) and DC13 (Custody Services Risk Requirement (CSRR) Applicable to a CSP).

Similarly detailed calculations are set out in the Derivatives Directives and Directive AA of the IRC Directives that are applicable to those types of JSE members.

	<p>The risk requirements are designed to calculate the losses that a member of the JSE may need to absorb and the FEBR is designed for the winding down of the business of a member over a 13-week period. The initial and ongoing capital required for members of the exchanges is intended to protect the financial system from systemic risk, allow for orderly liquidation on failure of a firm, allow for repayment of client liabilities and ensure that the members have sufficient liquid assets to meet ongoing liabilities.</p> <p>While there is no explicit requirement in the JSE rules for member firms to calculate their capital adequacy on a daily basis, the JSE requires that member firms must be certain that they have adequate capital every day. They must file monthly capital reports with the JSE, 10 days after the month end. Further, Equity Directives DA 1.1 and 1.3 require a member to keep its accounting records up to date at all times and to be able to calculate the its financial position at the close of business each day.</p> <p>The JSE relies on its on-line monitoring of equities member firms' positions. Firms must enter all cash trading and derivatives trading by 7:00 pm on each trading day. JSE members' listed derivative positions feed automatically into the JSE's capital adequacy system from the derivatives clearing system and their JSE equity positions are captured directly by the Broker-Dealer Accounting (BDA) system (the JSE's accounting system that is used by all equities members). The members separately report their OTC derivative positions to the JSE via an electronic reporting system.</p> <p>The JSE's capital adequacy system calculates the member's risk by netting the cash equity positions against the cash equivalent of their listed and OTC derivative positions to determine the member's market exposure for each equity instrument. JSE internal systems prepare a daily report on equities member firms' open risk positions and available liquid funds. If the internal report reflects that a firm may not meet the minimum requirements, JSE staff will contact the firm and obtain additional information in order to establish whether there is a real shortfall. If a shortfall is confirmed, the firm is required to remedy the situation by either closing out risk positions or injecting additional capital. If the JSE is of the view that a capital shortfall poses a threat to the market or a firm's clients, an Urgent Issues Committee can suspend the firm from trading. If this Committee does not take action, the firm may continue to do business. The JSE estimates that the majority of daily trading volume on the JSE is concentrated in the ten largest member firms.</p> <p>JSE Rules require member firms to hold client cash positions in a custodian account controlled by a JSE subsidiary. While equity positions of the firm and its customers are contained in an omnibus account, JSE internal systems maintain segregated records. JSE rules prohibit firms from borrowing customer securities.</p> <p><b>Reporting, review and early warning</b></p> <p>An FSP must maintain full and proper accounting records on a continuous basis and these records must be brought up to date no less frequently than monthly (FAIS Act, section 19).</p>
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FSPs must submit audited financial statements to the Registrar within four months after their financial year-end. The financial statements must be prepared in accordance with IFRS and audited in accordance with the ISA by an auditor registered under the APA and approved by the Registrar (FAIS Act, section 19(2)). (Certain sole proprietor FSPs that do not receive client funds or premiums may be exempt from the audit requirements.) The FAIS Act does not require auditors to provide specific assurance that the financial position of the FSP reflects the risks undertaken by that FSP. However, the auditor of a FSP must submit an additional report to the Registrar providing assurance that clients' funds were kept separate from that of the FSP (section 19(3)).

There are no routine interim capital reports required of FSPs. However, the Registrar may require the FSP to submit monthly management accounts within 15 days of the month end. This condition is routinely imposed on any FSP that has been exempted from any of the normal capital requirements.

An FSP's compliance officer must monitor the FSP's compliance with all requirements of the FAIS Act including the FSP's adherence to the capital adequacy requirements. The FAIS Act requires an auditor and compliance officer to immediately report to the Registrar any material non-compliance and failure to do so is a criminal offence (sections 17(1)(c) and 19(4)). These irregularity reports are considered high priority matters and are followed up on immediately upon receipt by the FAIS Division

FAIS Division reviews the FSP's capital levels on receipt of its annual financial statements and as part of its overall supervision of firms. This assessment of financial soundness feeds into the risk assessment model used for supervision. The division expects the FSP's key individuals to manage compliance with financial soundness requirements and also expects the compliance officer to monitor such compliance. Capital levels are also reviewed during on-site reviews.

However, there is no obligation on anyone to inform the FSB of a decline in the financial soundness of a firm until such time as the firm breaches the minimum capital requirements. The firm is not subject to any specific requirement to notify the FSB, if it is undercapitalized or under financial stress.

JSE members must submit monthly reports to the JSE regarding the capital adequacy for the previous month and the member's compliance with the capital requirements. These capital reports are due by the 10th of each month. As noted above, the JSE has the systems to monitor the capital adequacy of its equities members on a daily basis. The firm is also required to reconcile its monthly capital reports to its audited annual financial statements and the auditor must comment on that reconciliation (Equities Directive DB1).

All firms that make use of a JSE trading system and have settlement obligations in a JSE market generally must meet the same standards in relation to those matters. However, under the Derivatives Rules, banks are exempted from the requirement to file monthly capital adequacy reports (Rule 3.70.5). The JSE stated they defer to the SARB and its

capital requirements for these firms. South African banks are subject to the Basel III capital requirements, which are both more extensive and stringent than the JSE's capital formula.

FMA Board Notice 96 of 2013 requires members of exchanges to keep specified accounting records. Chapter XI of the FMA deals with auditing and sets out the functions of an auditor. Section 89 requires each member of an exchange to appoint an auditor. Section 90 requires a member to have its accounting records and annual financial statements audited, as does Equities Directive DG 1.7. Under the FMA, the audited financial statements must be provided to the exchange, and on request to the Registrar. Directive DB 1.1 requires the audited financial statements to be submitted to the JSE within three months of the year-end. Board Notice 100 of 2013 sets out the matters that must be reported on by an auditor of a regulated person, including a JSE member. These matters include confirmation that the requirements regarding segregation of client assets have been complied with.

A JSE member must be audited by an independent auditor registered to carry out public audits under the APA and that auditor must also have been approved by the JSE as entitled to audit member firms. The auditor will not be viewed to be independent if he is: an officer or employee of the member; an officer of another member; a person who has any direct or indirect financial interest in the business carried on by the member or exchange in question; or a close relative of an officer of the member. Close relative means the person's spouse, children, parents, brothers and sisters (Equities Directive DG).

Late reporting, a failure to report or having inadequate capital are breaches of the member's obligations under the JSE Rules and the JSE may take appropriate action, including moving to suspend or withdraw the member's membership in the exchange. In addition, the JSE is empowered to request additional capital to be provided or to direct that positions be closed, if additional capital cannot be provided (see for example, Equities Rules 12.40-12.60).

#### **Authority to act as capital falls**

See the description of the authority of the Registrar under the FAIS Act set out in Principle 32. These actions have been taken in practice. In particular, restrictions on taking on new business are often imposed until the capital of a firm is restored to the required amounts.

If a JSE member's capital falls below its minimum requirements and there is imminent danger that the member may be unable to meet its commitments, an Urgent Issues Committee may restrict the activities of the member (Equities Rule 12.70, Derivatives Rule 3.305 and IRC Rule 4.70). There has been no need to resort to action by the JSE's Urgent Issues Committee in recent times. In each instance when a member has been undercapitalized, the member has either been able to reduce its risk positions or introduce additional capital without there being a risk of it being unable to meet its

	<p>commitments.</p> <p><b>Risks from outside the firm</b></p> <p>There are very few provisions under the FAIS Act that address exposure to FSPs from related parties or off-balance sheet exposures and in general, the authority of the FSB under the FAIS Act only extends to the FSP, not to related companies. If there is some concern about such exposures, the FSB may ask for any information at any time from an FSP and the relationships between the FSP and other parties are assessed during on-site visits.</p> <p>Under the FAIS capital requirements, firms must deduct 100 percent of any investment in or loan to a related party from their assets for the purposes of calculating the positive net asset requirements.</p> <p>The JSE stated that off-balance sheet transactions are not widely used in the jurisdiction. This sort of financial engineering transaction might be used by banks, but not by JSE equities members. Under the capital requirements that apply to JSE members, any investment in an unlisted affiliate is discounted completely for capital adequacy purposes. The maximum current exposure of the member arising from any guarantee given, or assets pledged, to secure the obligations of a third party is also deducted. Listed company securities are not subject to special treatment, if the issuer is related to the member.</p>
Assessment	Partly Implemented
Comments	<p>The IOSCO Assessment Methodology requires that all market intermediaries be subject to capital adequacy standards and other prudential requirements, such as making periodic reports on the firms' capital and delivering audited financial statements to regulators. The capital adequacy standards and related reporting should be designed to achieve several purposes:</p> <ul style="list-style-type: none"> <li>• Address/promote solvency and liquidity at firms in order to support their continued operation;</li> <li>• Give the regulator warning of a potential failure to allow for early intervention;</li> <li>• Protect investors' assets from the failure of a firm;</li> <li>• Prevent the failure of a firm from disrupting the orderly operation of the market; and</li> <li>• Provide a cushion of assets that may be used to fund operations during an orderly wind down of the firm.</li> </ul> <p>The capital formula must be sensitive to the full range of the actual risks taken on at the firm (market, credit, liquidity and operational risks) and require additional capital as the risks at the firm increase, such as where higher risk activities are engaged in (e.g., proprietary trading) or larger positions are booked.</p>

	<p>The capital requirements must be backed up with regular and timely reporting to the regulator, including the receipt of audited financial statements at least annually. These financial statements and capital adequacy reports not only provide assurance to the regulator that the firm continues to be appropriately capitalized, they also serve to give early warning of declines in financial health or changes in the business carried on at a firm, and information that can be used to identify build ups of exposures at the individual firm and market-wide level that may be of concern.</p> <p>The capital rules under the FAIS Act are not risk-based except at the highest level of generality. They vary only by category of intermediary services licensed, not by the nature of the instruments held or the size of the firm's balance sheet. The requirements also do not generally take into account the risks that the firm may face from off-balance sheet exposures and exposures to related parties are only deducted for some categories of FSPs.</p> <p>Most FSPs only report their capital once per year via the audited financial statements. The requirement to keep financial records contemplates records being updated monthly. No interim reporting is required and no one is obliged to report any decline in financial position to the regulator until the minimum capital requirements have been breached.</p> <p>Under the JSE Rules, there are limited requirements that apply to off-balance sheet or related company exposures. The fact that there is no early warning requirement of a decline in the financial health of a member is of less concern than the similar gap for FSPs, owing to the daily monitoring of members by the JSE.</p>
<b>Principle 31.</b>	Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.
Description	<p><b>Organizational requirements and internal controls</b></p> <p>The provisions under the FAIS Act require management to ensure adherence to internal procedures. Policies and procedures are prescribed and the key individual(s) (management) are accountable for compliance with these requirements (Fit and Proper Notice, Part VIII). Changes to the business structure, relevant staffing, contact details, governance structures (shareholding/directors/members) must be reported within 15 days of such change occurring (Condition 1 of the standard licensing conditions).</p> <p>FSPs must have adequate controls over the execution of their services. There must also be policies and procedures, with the relevant controls, over issues such as access to data and financial controls. Disaster recovery plans must also be implemented and tested. Security and access control to data must be managed strictly (Fit and Proper Notice, Part VIII).</p>

Management is accountable for ensuring the firm adheres to the applicable laws, which include the relevant Code(s) of Conduct as prescribed by the Registrar. The role of the key individual is set out in Part I of the FAIS Act. Essentially, the key individual is held accountable for the rendering of financial services by the FSP. There can be one or more key individuals per FSP. Key individuals are subject to fit and proper requirements, which are assessed at the time they assume their roles. The requirements for the approval of key individuals are found in the Determination of Procedure for Approval of Key Individuals – Board Notice 122/2003.

The information that must be made available to clients, to the public, and the regulator is prescribed. Management is held accountable for ensuring that the information is available and up to date. The format is not prescribed, but the internal policies and procedures must ensure the availability and reliability of information. Each FSP must submit periodic compliance reports (section 17) and audited financial statements (section 19). The discretionary, hedge fund and administrative FSPs (Categories II, IIA and III FSPs, respectively) must submit biannual compliance reports.

The FMA, the rules of the JSE (that are approved by the FSB), and the notices published by the FSB stipulate the standards for internal organization and control and operational conduct that must be implemented by members to protect the interests of clients, ensure proper management of risk, and under which conditions members accept primary responsibility for these matters. They also address minimum requirements for keeping accounting records. The rules of the exchange make provision for know your client obligations and require each member to appoint a compliance officer who is responsible for ensuring that the member complies with the legislation and the rules of the exchange. A member must also sign a mandate with each of its clients, which must comply with the requirements of the exchange.

JSE Equities Rule 4.70 (Internal control and risk management) requires in 4.70.1 that members employ the resources, procedures and technological systems that are necessary for the effective conduct of their business. Rule 4.70.2 specifies the internal controls that are to be employed by members in the carrying out of their business and the safeguarding of the assets of the member and its clients. The requirement that sound risk management principles and procedures be adopted is expressed in 4.70.3 and the requirements in respect of these principles and procedures are detailed in 4.70.4.

For example, under Rule 4.70.4 the risk management system of the member 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:

- Identify, quantify, control and manage the risk exposures of the member;
- Make timely and informed business decisions; and

- Monitor the performance and all aspects of the business of the member.

Members that are responsible for safeguarding client assets are required by Directive FK 1.1 to implement governance structures and an organizational culture that evidences a commitment to effective control by executive management and the board of directors over all aspects of the member's business. If the safeguarding of client assets is outsourced to another member, that other member also is required to meet those requirements.

See also the discussion under Principles 10 (records) and 29 (structure and internal controls).

#### **Periodic evaluation of controls and risk management systems**

The compliance function of an FSP is required to conduct periodic reviews of the processes involved with the rendering of financial services, and to issue reports to management. A periodic compliance report in a prescribed form must also be issued to the regulator on the monitoring performed; the frequency of the reporting depends on the category of firm and whether the compliance officer is internal or external. The requirements are prescribed in Board Notice 127 of 2010, Notice on Qualifications, Experience and Criteria for Approval of Compliance Officers, 2010 (BN 127). Category I and IV FSPs must be reviewed and monitored at least quarterly if they use external compliance officers, and annually if there are internal compliance officers. Category II (discretionary), Category IIA (hedge funds) and Category III (administrative FSPs/LISPs) are required to be reviewed and monitored at least monthly by external compliance officers and quarterly if they use internal compliance officers.

If the firm has outsourced its compliance function to an external firm, this firm is subject to initial approval and ongoing supervision by the FSB. One of the fit and proper requirements that apply to these firms is that they must be able to provide independent and objective compliance services to their clients (BN 127). Other than this, there are no specific structural or organizational independence requirements that apply to compliance officers.

The JSE rules do not specifically require all members to be subject to a periodic, objective review of their internal controls and risk management systems. But under Equities Directive FK 1.1.3, all members who are responsible for safeguarding client assets are required to have an appropriate internal audit function in place as part of their governance and management oversight arrangements.

The external auditor is required to provide the FSB with an annual report on the compliance of the firm with the requirements under the FMA with respect to segregation of client funds and securities (Board Notice 100 of 2013).

Under Equities Directive DG 1.7.2, the external auditor must report to the JSE's Director: Surveillance on the results of procedures agreed with the Director: Surveillance to establish whether adequate controls exist to ensure that signed mandates are held for

investment management and custody clients, and any material matter relating to internal controls, record-keeping or non-compliance with the FMA or the rules and directives which has come to the notice of the auditor and which, in his/her opinion, the member should give attention to or of which the Director: Surveillance should be made aware.

### **Compliance function**

Virtually all firms operating in South Africa have to have a compliance officer who must meet fit and proper requirements specified by the FSB or the JSE. FSPs that have more than one employee in a regulated role are required to appoint compliance officers (FAIS Act, section 17). The FAIS Division performs on-site visits that include a review of the compliance function. Any deficiencies are addressed with the business itself.

JSE Equities Rule 4.30 deals with compliance officers and stipulates that:

- A member must appoint a compliance officer to assist the board of directors of the member in ensuring compliance by the member with the FMA, the rules and the directives.
- The person to be appointed as a compliance officer must have obtained a pass in the compliance officer examination prescribed by the JSE and, if required, be able to evidence to the Director: Surveillance that he has subsequently maintained an adequate knowledge of the FMA, the rules and the directives.
- A compliance officer must:
  - With the necessary support and guidance from the board of directors of the member, implement the resources, systems and procedures required to promote and monitor compliance by the member and its employees with the FMA, the rules and the directives;
  - Report to the Director: Surveillance any breaches by the member of the FMA, the rules and the directives or any other issue considered by the compliance officer to be irregular; and
  - Ensure that the content of the JSE Gazettes is communicated to and understood by all relevant employees.

The effectiveness of the compliance function of members is assessed during the JSE's on-site examinations of members. If deficiencies are identified, the member would be instructed to take suitable remedial action.

### **Conflicts of interest**

There are conflicts of interest requirements in the General Code of Conduct, which applies to all FSPs. Conflicts must be avoided; if unavoidable they must be mitigated and disclosed clearly. The General Code of Conduct also addresses both the prohibition of incentives (section 3A) and the overall management of conflicts of interest (section 3(1)(b) and (c)). The provisions of section 3A prohibit certain incentives and deal with

both the giving and receiving of incentives. A distinction is made between incentives given to an external party and those given to a representative. For securities products, FSPs may only receive a financial interest, other than an immaterial financial interest, if the client specifically agrees to the fee in writing and can stop the fee at any point at the client's discretion. "Immaterial interest" is widely defined and is limited to ZAR 1,000 per year per representative or FSP. Representatives may receive any remuneration, but it may not give preference to the quantity of business to the exclusion of the quality of the financial services; a specific product supplier; or a particular product.

Rule 8 of the JSE Equities Rules deals with conduct of business. This rule provides for the general standards of conduct which members are required to observe in their dealings with clients and the JSE. The additional standards of conduct relevant to specific regulated services are contained in the rules that deal with those specific services. Under Rule 8.10.2.5, in its dealings with clients, a member must avoid conflicts of interest and when they cannot be avoided, ensure fair treatment of clients by disclosure, confidentiality or declining to act. A member must not unfairly place its interests above those of its clients.

#### **Direct market access**

The JSE Equities Rules allow for direct market access, which is defined in the Rules as the process whereby an order is received electronically by a TSP from a client and then submitted electronically to the JSE equities trading system by means of an order entry application operated by the TSP, without the intervention of a registered securities trader.

The Equities Directive BT specifies that order entry applications may not be operated without the prior written approval of the JSE (BT9) and sets out the key objectives that must be met, which includes the requirement that the member's order entry application must be able to verify the client's capacity to settle a transaction before an order is submitted to the trading system (BT 10.3). (See Principle 33).

#### **Client asset protection**

Under the FAIS Act, specific controls and procedures must be in place at an FSP to segregate client money and assets from that of the firm. These controls must be audited and reported on annually. There are specific requirements for the return of those assets in certain events such as insolvency, etc. A provider who receives or holds financial products or funds on behalf of a client must account the products or funds properly and promptly and:

- Provide receipts for funds and assets received;
- Take reasonable steps to ensure that any assets or funds under its control are adequately safeguarded;
- Open and maintain a separate account, designated for client funds, at a bank

and pay any funds received for or from clients in that account within one business day of receipt;

- Take reasonable steps to ensure that:
  - At all times such financial products or funds are dealt with strictly in accordance with the mandate given to the provider;
  - Client financial products or funds are readily discernible from private assets or funds of the provider; and
  - Subject to any applicable contractual or statutory provisions, a client has ready access to any amount paid into the separate account, less any deductions which are authorized, and charges and fees required or authorized to be paid by law.

These obligations with respect to client assets are found in section 19 of the FAIS Act and sections 10 - 12 of the General Code of Conduct, section 5 of the Administrative Code of Conduct and section 4 of the Discretionary Code of Conduct.

There are segregation and safekeeping requirements applicable to JSE members set out in the FMA and in the JSE Rules.

- Section 21 of the FMA requires client funds to be held in a separate trust account and sets out detailed requirements on the operation of that trust account and how those funds may be used. Section 22 of the FMA requires segregation of securities held by a member for its own account from those held on behalf of its clients. Client assets must be held in one or more separate securities accounts.
- Section 9 of the JSE Equities Rules deals with client assets and requires of members to provide for the separation and identification of the assets of a client and the assets of a member. Funds received by a member from a client must be segregated from the member's own funds. All members that assume responsibility for safeguarding client assets have to meet specific criteria under Rule 3.70 in order to be authorized to perform that function.

If clients' assets are kept in a nominee company, such nominee must comply with the nominee requirements of the FSB and JSE.

### **Client complaints**

Each FSP is required to develop and implement a complaints policy and related procedures. The timeframes for steps to be followed in resolving a complaint and the escalation of the matters are prescribed. Clients also have recourse to the FSB's Ombud's Office if they are dissatisfied with the response (General Code of Conduct, sections 16 – 19). The Ombud's arrangements are prescribed in Chapter VI of the FAIS Act.

Section 17(2)(t) of the FMA requires the exchange to have rules in place "for the

manner in which complaints against an authorized user or officer or employee of an authorized user must be investigated.” The JSE's client resolution scheme has been recognized under the Financial Services Ombudschemes Act under which an ombudsman addresses qualified client complaints.

JSE Equities Rule 11.20 requires each member to have internal complaint handling procedures that must be designed to ensure that: all complaints are handled fairly, effectively and promptly; any recurring or systematic problems are identified, investigated and rectified; and the number of unresolved complaints referred to the exchange is minimized. There are similar requirements set out in Section 17 of the Derivatives Rules and Section 5 of the IRC Rules.

### **Know your client and suitability**

#### *Know Your Client*

The requirements for client identification are prescribed in section 21 of FICA and apply to all accountable institutions. That term includes managers of CIS other than participation bond, securities FSPs and members of the JSE. The FSB is a Supervisory Body responsible for supervising the compliance of regulated entities with FICA.

The regulations made under FICA provide a guideline setting out the acceptable methods to establish and verify the identity of individuals and legal persons, including companies, close corporations, foreign companies, partnerships, trusts and other legal persons.

Under section 8(1)(j) of the FMA, the exchange is required to have made arrangements for the efficient and effective supervision of authorized users so as to ensure compliance with FICA. The FMA further requires the exchange rules to make provision for the supervision by an exchange of compliance with the duties imposed on it and its authorized users by FICA (section 10(2)). The relevant rules regarding such supervision are contained in the JSE Rules on Supervision and Enforcement (Section 12).

Under section 45(1) of FICA, the FSB is responsible for supervising compliance by the JSE members with sections 21 to 45 of FICA, which deal with client identification and reporting. However, the JSE assists the FSB with ensuring compliance through delegated supervisory powers under section 45(1B)(b).

The JSE Equities Rules also require that members obtain and maintain sufficient information on each client account and each account operated by the client, in order to establish the identity of the client and specify the information that must be obtained in order to fulfill this requirement (Rule 8.60).

#### *Suitability*

Section 8 of the General Code of Conduct requires that suitability information must be collected and assessed before a client is provided with advice. An FSP must:

- Take reasonable steps to seek from the client appropriate and available

information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice;

- Conduct an analysis, for purposes of the advice, based on the information obtained; and
- Identify the financial product or products that will be appropriate to the client's risk profile and financial needs, subject to the limitations imposed on the provider under the FAIS Act or any contractual arrangement.

The JSE Equities Rules require that investment mandates must be entered into between members and their clients. Where discretion is exercised in the management of client assets, information as to the financial situation, investment experience and objectives of the client must be obtained. An investment needs analysis must be undertaken by these members, which determines the client's risk profile. Based on this information, the member may make appropriate investment decisions on behalf of the particular client (Rule 8.120). A similar rule applies to derivatives and interest rate and currency market members.

#### **Contracts with clients**

Written contracts or account agreements (called mandates) are specifically required for discretionary managers, hedge fund managers and LISPs (Administrator and Discretionary FSP Codes of Conduct, section 5). Otherwise, client contracts are not routinely used and not required. (But see the extensive other information that must be provided to clients set out below that would encompass the general and specific terms of doing business with a given firm.)

JSE Equities Rule 8.120.1 says that if an ISP manages JSE authorized investments on behalf of clients, the arrangement must be recorded in a written mandate.

#### **Reporting to clients**

Section 3 of the General Code of Conduct obliges FSPs to adequately and transparently disclose certain information including fees, risks, past performance, costs, etc. when rendering financial services to clients, including potential instances of conflicts of interest that may arise when rendering financial services and the steps taken to manage or deal with them. Similar requirements apply to members under the JSE Rules.

#### *Investment disclosure*

Under section 7 of the General Code of Conduct, 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 and provide to the client any material contractual information and

any material illustrations, projections or forecasts in the possession of the provider.

JSE Equities Rule 8.130 provides that the member must take reasonable steps to ensure that the client understands the investment advice he is given, as well as the nature of the investment and the material terms and risks involved in the particular transaction, which would enable the client to make an informed decision.

If the product is a new issue for which a prospectus or other disclosure document is available, this document must be made available to the purchaser or the firm must be sure that the investor is aware of the contents of the prospectus. See the discussion in Principle 16.

#### *Client statements*

The applicable Codes of Conduct require FSPs to report at least annually to their clients. Under section 7(4) of the General Code of Conduct, the statements must contain details (on a product-by-product basis) of any ongoing monetary obligations of the clients with respect to the product, the value of the investment and any ongoing incentives etc. payable to the FSPs with respect to the product.

Under the Administrative and Discretionary Codes of Conduct, clients must be sent quarterly statements. Both Codes also require much more detailed information to be provided to clients on request (Administrative Code, section 10; Discretionary Code, section 6).

The JSE's Equities Rules say that a member must provide a written statement to a client that complies with Rules 8.180.3 and 8.180.4. Statements are to be provided to clients at regular intervals that may not exceed three months (or monthly if the client so requests). They must be provided monthly, if the client's portfolio as managed by the member includes any transactions or positions in derivative instruments. Under the JSE's Derivatives Rules, an investment manager must provide a written statement to a client on a monthly basis that complies with Rules 15.50.2 and 15.50.3. Similar provisions are contained in Rule 10.210 of the JSE's IRC Rules. The three sets of Rules set out detailed information that must be included in the client's statement.

In all cases under the Administrative and Discretionary Codes and the JSE Rules, the information provided must be sufficient for the client to:

- Produce a set of financial statements;
- Determine the composition of the portfolio held and the changes thereto over the reporting period, if applicable; and
- Determine the market value of the investments and the changes therein over the reporting period, if applicable.

#### *Fees*

The General Code of Conduct (section 7) and the Codes of Conduct for Administrative and Discretionary FSPs (section 5(1)) require disclosure of any charges and fees to be

paid by the client. The basis of the fees and the manner they are levied (deduction from the amount of the financial product or otherwise) must be disclosed. Rebates or commissions paid by other FSPs or product suppliers for placing client funds must also be disclosed.

JSE Equities Rule 8.10.3 requires members to disclose full and accurate information about the fees and other charges that may be levied on clients and reflect them in specific monetary terms. Rule 8.70 of the JSE's IRC Rules deals with trading, clearing and settlement fees. It permits the levying of fees in accordance with a published schedule of fees. No other fee may be charged to a client without the prior written agreement of the client having been recorded in the client agreement. Similar provisions are contained in Rule 8.80 of the JSE's Derivatives Rules which deals with trading fees. Under Rule 16.10.4.2.1 of the JSE's Derivatives Rules a member must disclose full and accurate information about the fees and any other charges that may be levied on clients.

### **Standard of care**

Section 2 of the General Code of Conduct requires the FSP at all times to render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry. The JSE Equities Rule 8.10 (General standards of conduct) specifies that in their general dealing with clients, members must act with due skill, care and diligence and in the interests of their clients.

### **Supervision of intermediaries**

#### *FAIS Division*

The FAIS Supervision Department supervises FSPs using a risk-based approach. The approach has been enhanced recently in response to the changing face of the regulatory landscape, international trends and outcomes of previous years' on-site visits. This enhancement entailed the revision of the risk-based framework, the risk elements and the implementation of an annual program to review FSPs' profiles. The purpose of the enhancement is to sharpen the focus on areas where non-compliance was concentrated and equip supervisors to be more proactive.

Under the FAIS RiBS framework, there is an initial rating allocated to an FSP when the license application is approved, which is based on the information submitted during the application process. Ratings vary by factors such as nature of intermediary service provided (discretionary services are viewed as higher risk), products offered, number of representatives, and assets under management. This initial rating is then updated as part of the various processes within the FAIS Division, e.g., when an on-site visit is conducted. The information received via complaints, profile changes, audit reports, financial statements and compliance reports may have an effect on a firm's risk rating. Specific problems may be picked up while analyzing annual compliance reports (e.g., the FSP does not have a documented risk management plan).

Training is conducted with all new analysts within FAIS Supervision Department to ensure that the risk measurements are applied consistently. This aims at ensuring standardization of the manner risk ratings are done. Ad hoc training sessions are also conducted, if certain aspects of RiBS need to be addressed. The FAIS Supervision Department also presents a session on RiBS as part of the induction program that all new staff members in the division are required to attend.

FSPs are required to submit annual financial statements, audit reports and compliance reports to the Registrar. The frequency of compliance reporting depends on the FSP's category of registration and risk category. FSPs carrying on higher risk activities submit bi-annual compliance reports and, where required, monthly management accounts.

Further, auditors and compliance officers are obliged to file reports promptly when breaches of the rules are detected (irregularity reports). An electronic submission system was introduced in August 2012 to facilitate reporting. These reports are investigated promptly and play an important role in the proactive identification of potential areas of non-compliance.

This information assists the Registrar to monitor compliance levels of FSPs and to assess major risks on a continuous basis.

#### *Risk categorization of FSPs*

All FSPs are assigned to a risk category: small, small-medium impact (SMI), medium impact, medium-high impact (MHI) and high impact. The intensity of supervision then differs for the different impact categories.

The table below shows the categorization of securities FSPs (Category I to III) under the risk-based supervision approach as at the date of the assessment mission. See the description of the activities these firms may undertake in Principle 29.

#### **Risk Categorization of FSPs**

<b>Category of FSP</b>	<b>High Impact</b>	<b>MHI</b>	<b>Medium Impact</b>	<b>SMI</b>	<b>Small</b>	<b>Total</b>
Category I	51	256	1,702	1,173	1,454	4,636
Category II	40	270	50	140		500
Category IIA	22	59	13	21		115
Category III	26					26
Foreign FSPs (all categories)		8	38	14	9	69
<b>Total</b>	<b>139</b>	<b>593</b>	<b>1,803</b>	<b>1,348</b>	<b>1,463</b>	<b>5,346</b>

Source: FSB.

The supervision activities include:

- Desk-based review of all compliance reports, financial statements and irregularity reports;
- Planned on-site visits at High Risk entities;

- Planned management meetings with High Risk entities, if there are regulatory concerns;
- On-going quarterly meetings with the compliance officers of FSP groups;
- Participation in the inter-regulatory supervisory colleges for banks and insurance groups;
- Planned thematic reviews of certain types of FSPs;
- Ad hoc reviews at FSPs, usually conducted as:
  - A result of complaints or tip-offs that were received; or
  - When an existing FSP amends its authorization to include hedge funds (Category IIA) or Category III activities.

All reports filed by or about an FSP are reviewed. Irregularity reports are treated as priority items.

#### *Selection criteria and review cycle*

The risk-based approach guides the selection of FSPs for on-site visits.

- High and MHI FSPs, including hedge funds, are reviewed on a 24 month cycle;
- All Category III FSPs (LISPs) are reviewed annually;
- All High Impact Groups are reviewed on a 12 month cycle, alternating between a full on-site visit and a management meeting; and
- Medium Impact FSPs are reviewed on a 3–5 year cycle.

All other FSPs are reviewed on an ad hoc cycle. Every firm is seen periodically. Issues that result in an ad hoc review include questions about solvency, adherence to the Code of Conduct and irregularity reports that have been lodged about an FSP. Most often the FSPs are identified for review based on concerns emanating from desk-top analysis of annual reports that were submitted.

#### **FAIS On-site Visits January 2011 – March 2014**

Instruction only FSPs (Category I)	1,173
Discretionary FSPs (Category II)	358
LISPs (Category III)	24
Hedge Fund FSPs (Category IIA)	88
<b>Total</b>	<b>1,643</b>

Source: FSB.

These reviews include reviewing elements of:

- Corporate governance–legal structure;
- Strategy, business scope, expansions, joint ventures, jurisdictional operations;
- Contractual relations (corporate structure and third party relationships,

	<p>contractual agreements with clients);</p> <ul style="list-style-type: none"> <li>• Customer relations, adherence to Codes of Conduct, Treating Customers Fairly;</li> <li>• Disclosures, needs analysis, suitability reviews, record of advice, risk disclosures, conflict of interest declarations;</li> <li>• Operational ability, including infrastructure and IT;</li> <li>• Financial soundness (solvency);</li> <li>• Segregation of business and client funds;</li> <li>• Compliance and legislative adherence;</li> <li>• Risk management; and</li> <li>• Staff: controls, policies, procedures</li> </ul> <p>Risk assessment visits focus on the firm's internal systems for management and accounting of clients' assets, the segregation of the firm's and clients' assets, internal risk management controls and the firm's compliance office operation. The FSB staff typically review a sample of firm's customer files to confirm the accuracy of firm records and consistency of investments with documents indicating investor preferences.</p> <p>FAIS Supervision Department has 40 examiners who conduct between 500 and 550 full on-site visits a year.</p> <p>In the period January 2011-March 2014, the FAIS Supervision Department conducted 317 management meetings. These meetings cover a review of findings of previous inspections; changes in the firm; overall adherence to legislation; structure, governance, expansions and joint ventures; and any other issues that have come to the attention of the Registrar.</p> <p>If issues are identified during the supervision activities, recommendations on corrective actions are issued to the FSP to address the risk areas identified. Regulatory and enforcement action may be taken against FSPs for failing to address the regulator's concerns and recommendations.</p> <p><i>JSE</i></p> <p>The JSE has a review program in place to assess members' compliance with the various requirements pertaining to the provision of investment services. The JSE's member supervision activities comprise a combination of on-site and off-site reviews. The off-site reviews are facilitated by the use of surveillance systems, particularly in the equities market, which give the Market Regulation Division of the JSE electronic access to members' financial records and client records. The monitoring of members' compliance with the JSE's capital adequacy requirements and the safeguarding of client assets rules is done on an on-going basis using these systems. Potential breaches can be identified through the use of these systems and the systems also identify indicators of potential</p>
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internal control weaknesses that are taken into account in the on-site review program. The on-site review program focuses on internal controls regarding the safeguarding of client assets, investment management and advisory practices, the management and control of the member firms and compliance with anti-money laundering legislation.

Over the past three years the JSE has conducted the following onsite reviews:

#### JSE On-site Reviews

	2011	2012	2013
<b>Equities members</b>			
Client assets	3	6	3
Investment services		10	4
Anti-money laundering		17	10
Management and control		18	10
<b>Derivatives members</b>			
Client assets		5	12
Investment services	11	5	12
Anti-money laundering		5	12

Source: JSE.

These figures reflect the number of members that were subject to a review in respect of each particular aspect of regulation, e.g., client assets. A single member could therefore be subject to a review more than once across each of the aspects of regulation in a particular year.

Each of the above reviews was planned. There were no reviews over the past three years that were necessitated by complaints or queries. There were no thematic reviews over the last three years, as the JSE did not identify any particular themes that warranted such an approach.

The regulatory impact of each member firm is considered in determining which members are subject to a review and the frequency of those reviews. The first criterion is whether a member provides services to clients and, if so, which services. Members who only trade for their own account or only provide execution services would typically not be subject to an on-site review. Full service members who are authorized to safeguard client assets and provide investment management and execution services are regarded as having the highest regulatory impact and are generally subject to an on-site review every two years. Members who are only authorized as ISPs still have a high regulatory impact and are generally subject to an on-site review every three years. The frequency of review may also be influenced by the results of the previous review and any risk indicators coming out of the off-site desk-based supervision.

The findings of on-site reviews of internal control arrangements and business conduct practices are communicated to the reviewed member in writing and the member is required to take the necessary remedial action. Short term breaches of capital requirements (as opposed to concerns regarding the ongoing ability of a member firm to meet its financial obligations) are typically addressed through remedial action by the

member prompted by the JSE rather than formal enforcement action. The JSE would likely take enforcement action against a member, if the nature of the weaknesses was severe or if the weaknesses had resulted in some form of prejudice to clients.

JSE equities members are regulated by the JSE in respect of their activities in what the rules refer to as "JSE authorized investments". This includes transactions in securities listed on other exchanges (including foreign exchanges) and both local and foreign CIS. Therefore, the extent of the JSE's regulatory remit extends beyond transactions in securities listed on the JSE. However, the regulation of non-JSE listed investments relates only to the provision of services to clients in respect of those investments. That includes discretionary management services, investment advice and the safeguarding of the clients' assets. If an equities member were subject to the trading or settlement rules of another exchange in respect of transactions on that exchange, the JSE would not monitor compliance with nor enforce those rules as the relevant other exchange would do so.

Further, the JSE does not regulate equities members' activities in instruments or intermediary services that fall outside the definition of JSE authorized investments. For example, transactions in unlisted shares or OTC derivatives such as contracts for difference are not regulated under the JSE rules. An equities member is required to obtain an FSP license, if it wishes to invest on behalf of its clients in those securities and would be regulated by the FSB under the FAIS Act in relation to those activities.

Under the Equities Rules, the dominant business activity of an equity member must be in activities in authorized investments and so under the principal oversight of the exchange (Rule 3.30.2.1). However, the same rule does not apply to JSE derivatives members' or IRC members' business, where a bank or large asset manager may be a direct member. The JSE's supervision of a member that is a bank or the majority of whose principal business activities fall under the FAIS Act is limited to the supervision of the firm's compliance with the JSE Rules on the relevant markets and ensuring that they meet their settlement obligations. The JSE does not otherwise participate in the ongoing supervision of those firms. The FSB does not routinely share the results of its examinations with the JSE, because it is examining issues that are relevant to the FSB's rules, not those of the JSE. For example, if the JSE is not regulating the relationship between a large asset manager and its clients, in the FSB's view the JSE has no reason to have insight into the FSB's findings in relation to those relationships. The same applies to the prudential supervision of banks that is primarily the responsibility of the SARB, even if they are JSE derivatives or IRC members.

The rules of the JSE are being rewritten to make it clear which rules will be applicable to these firms and which not, and the extent of the JSE's supervisory activities will then be more transparent as they will flow from those rules.

The limitations on JSE oversight described above apply to very few members in the derivatives market that would also be FSPs. For example, there are only three large investment managers who trade listed derivatives as members of the JSE derivatives

	markets. The JSE stated that all of the JSE, FSB and those firms are aware of the respective responsibilities of the regulators.
Assessment	Broadly Implemented
Comments	<p>The requirements that apply to FSPs generally are in compliance with the expectations of the Assessment Methodology, with the exception of the requirement that there be a periodic, objective assessment of the risk management and internal controls processes in place at the regulated firm. Under the Assessment Methodology, this review is required to be conducted by someone of sufficient independence from the firm. There is a requirement in South Africa that the regulated entity's auditor review annually the firm's compliance with the rules regarding treatment of client assets, but this does not extend to other controls. The compliance officers are required to report on the FSP's compliance with all requirements under the relevant laws, but there are no requirements in place that ensure the independence of the compliance function from the rest of the firm.</p> <p>The fact that the responsibility for the supervision of JSE members and FSPs has been divided between the FSB and the JSE has a potential to lead to regulatory gaps. The JSE carries the primary responsibility for the supervision of exchange members, but it is focused only on the business that is covered by the JSE Rules. Exchange members may however also provide other services that are not covered by these Rules. For these activities the members are licensed as FSPs and subject to the supervision of the FSB. There is a risk that differences in understanding of the respective responsibilities of the JSE and FSB and the actual scope of supervision applied may lead to gaps or duplication in the supervision applied to activities at JSE member firms. Supervision of these "shared firms" could be improved by routine sharing of the results of inspections performed with the other authority.</p> <p>The Assessment Methodology does not require that all clients be provided with a written contract. It does require that that the client be given (in writing) the general and specific conditions of doing business with the intermediary. While South African intermediaries are required to provide extensive written disclosure of their terms, particularly with respect to fees, it might assist clients in comparing FSPs and in clearly understanding all applicable terms, if all intermediaries were required to provide all clients with written contracts.</p>
<b>Principle 32.</b>	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p><b>Plans and powers</b></p> <p>There is no written plan at the FSB to address a failure of an FSP, however, the FSB has extensive powers to take action and many of these have been exercised in practice.</p> <p>The FSB has broad powers to take action where an FSP is failing or has failed. The</p>

	<p>Registrar may:</p> <ul style="list-style-type: none"> <li>• Conduct on-site visits and compliance visits where deemed necessary both on a routine and on an ad-hoc basis. The purpose of these on-site visits is to establish any contraventions and the extent of such contraventions. Once a contravention is established, the Registrar can direct that such non-compliance or transgression be rectified within a specific time.</li> <li>• Require that the business of an intermediary be subjected to a formal inspection. This inspection is more advanced, detailed and conducted by a special team of inspectors on a forensic investigatory basis. The Registrar will take action based on the outcome of the inspection.</li> <li>• Apply to the court for the business of an intermediary to be placed under curatorship or put into liquidation or sequestration. On agreement with the firm, the Registrar may also appoint a statutory manager (Protection of Funds Act, sections 5 and 5A and FMA, section 96)).</li> <li>• Direct an intermediary not to acquire new business subject to conditions and for a period determined by the Registrar, suspend its license for a period determined by the Registrar or withdraw the approval of an intermediary. These orders may be subject to any terms the Registrar deems necessary for the protection of the interests of clients, which authority is interpreted widely.</li> </ul> <p>All of these actions may be taken promptly and without prior notice to the firm in urgent circumstances.</p> <p>In addition, under the General Code of Conduct, an FSP that ceases to operate must immediately inform its clients and take reasonable steps to ensure that any outstanding business is completed or transferred to another authorized FSP (section 20(b)).</p> <p>The JSE also does not have a written plan in place to address the failure of a firm, although an exchange-wide contingency plan is in development.</p> <p>The JSE has the authority to order a member to suspend operations, if it defaults on trades and can also suspend operations if the firm is below minimum capital adequacy. The JSE also has the authority to take over a defaulting member for the purpose of ensuring the settlement of outstanding transactions and the return of client assets.</p> <p>The rules of the exchange deal comprehensively with the procedures in cases where a member of the exchange is suspended or declared a defaulter. For example, the rules of the JSE state that if a member is unable to meet its commitments to other broking members, a JSE settlement system, or a non-member arising out of an exchange transaction, the JSE Executive may declare the member to be a defaulter as from the time when the act of default occurred. The member must cease to be a member upon the passing of a resolution by the JSE Executive declaring it to be a defaulter. Also, a Participant Failure Manual has been prepared for the participants of Strate.</p>
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Similar default rules apply under Section 13 of the Equities Rules, Section 11 of the IRC Rules and Section 12 of the Derivatives Rules. For example, Section 13 of the Equities Rules clearly sets out the conduct that constitutes a default by a member in 13.10, the steps that will be taken by the JSE as a result of such default in 13.20, the settlement of open positions in 13.30 and states in 13.20 that the default of a member will result in the provisional termination of its membership and sending all members a notice advising of the member's default. The member in default will then provide the JSE with the required financial records to identify, protect and return assets of clients and to facilitate the settlement of outstanding transactions in securities, as well hand over to the JSE the control of all client assets. Client assets will be returned to the clients or delivered to another member on agreement with the client.

### **Early warning**

The Registrar may detect non-compliance through ad-hoc compliance visits at FSPs. In addition, the auditor and compliance officer of the FSP must immediately notify the Registrar of any material non-compliance by the FSP with any provision of the FAIS Act (sections 17 and 19). There is no obligation on any of the firm, auditor or compliance officer to inform the FSB of any general decline in the financial soundness of a firm until such time as the minimum capital requirements are breached. The Registrar also relies on complaints lodged by clients or other persons against FSPs to detect non-compliance by FSPs. The Registrar has developed and maintains a complaint system that records all complaints against an FSP or any other regulated entity,

The JSE has mechanisms in place to identify potential defaults of its members at an early stage. The JSE monitors the solvency and capital adequacy of its members on the basis of Equities Directive D (Member's Financial Management and Reporting). The calculations and returns as specified in directive DC (Members Financial Resource Requirements) enable the JSE to determine in good time whether there exists the possibility of a default by a member and then proceed in accordance with Section 13 (Default).

As noted above, the JSE internal systems also provide detailed access to firm positions and open exposures and provide an effective early warning system.

### **Insurance, guarantee funds**

There is no general investor protection/compensation fund in South Africa that provides compensation to any investor who loses money or assets on the failure of a market intermediary. However, under the FAIS Act, all FSPs must maintain adequate professional indemnity and fidelity insurance. These policies provide compensation for claims instituted by clients against the FSP or its representatives.

FSPs are required to maintain:

- Professional indemnity cover (a minimum of ZAR 1 million, calculated for the scope of the specific business). This insurance provides coverage when a claim

	<p>is lodged against an FSP or its employees for restitution when a client has suffered losses or damages as a result of a professional action of the FSP or its employees.</p> <ul style="list-style-type: none"> <li>• Fidelity insurance cover (for all FSPs that collect premiums or manage client assets – also a minimum of ZAR 1 million, calculated for the scope of the specific business). This form of insurance provides coverage in the event that an FSP incurs losses as a result of theft or other acts of dishonesty by its employees. Fidelity insurance protects the FSP from loss of money, securities, or inventory resulting from crime.</li> </ul> <p>The FSB expects that these policies would cover a substantial percentage of client losses in the event of a failure of an FSP.</p> <p>Further, there are guarantee and default funds established by the JSE and SAFCOM that provide some protection/compensation for clients in the event of member failure.</p> <p>The JSE established a guarantee fund to cater for default of a member. Equities Rule 2.130 (JSE Guarantee Fund) states that the JSE must establish a guarantee fund that is funded by members and out of which is to be paid claims arising from liabilities incurred prior to the default of the member. All equities members are also required by Directive DA 3 to be covered by an indemnity insurance policy that provides protection to the clients of the defaulting firm in the event that they have suffered loss due to fraud, theft or dishonesty. The JSE Guarantee Fund Rules provide for the legal structure of the Fund, its administration and investments, its assets, contributions and liability of the Fund for losses, claims, etc. The Fund is a trust and is administered by the trustees in compliance with the Fund Rules. The trustees of the Fund are independent non-stock broking members of the controlling body of the JSE as nominated and elected by that controlling body from time to time. The JSE acts as the secretary of the Fund.</p> <p>The Fund only covers the risk of member default in respect of accounts of clients on whose behalf the member is acting and whose assets are under that firm's control. The Fund is liable for losses where a member has been declared to be in default in terms of the JSE Equity Rules up to the limit set in the rules. The Fund Rules permit the liability of the Fund to extend to such other losses as the Fund trustees may determine.</p> <p>The JSE Guarantee Fund Rules state that "the net assets of the Fund shall at all times be at least ZAR 50 million or such other amount as the Registrar may determine from time to time, after consultation with the trustees."</p> <p>Reimbursement of the losses suffered by clients of a defaulting member may not exceed the sum of ZAR 500,000 per claimant. If the aggregate of all claims admissible against the Fund exceeds the total net assets of the Fund, the liability of the Fund is to be distributed in the ratio, pro rata, which the total net assets of the Fund bear to the total claims of the claimants that are admissible against the Fund.</p> <p>A claim by a client of a defaulting member is, at first instance, against the defaulting</p>
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member. The Fund is only liable for claims that the defaulting member is unable to meet and that are not covered by an insurance policy that otherwise indemnifies the member against such a claim.

Costs incurred by the JSE in the process of guaranteeing trades are reimbursed to the JSE from the surplus assets held in the Fund.

There is a default fund for the derivatives clearing house (SAFCOM) covering the losses arising from a shortfall in margin following the default of a clearing member. All clearing members are required to contribute to the fund. The JSE contributed a total of ZAR 100 million to the ZAR 500 million default fund. The remaining ZAR 400 million is funded by the clearing members in proportion of their average initial margin with the JSE over the prior quarter. The size of the fund is updated quarterly. Changes to the size of the fund are made in increments of ZAR 50 million. In case of default by one of the clearing members and use of the default fund, it must be recalculated and refunded within three trading days.

Daily reports produced by the system allow the SAFCOM Risk Management team to monitor clearing members' exposures and assess the adequacy of the SAFCOM default fund to cover unexpected losses.

There is also a Fidelity Fund for the derivatives market that covers limited losses arising from fraud or default of any market participant. It also applies to defaults in the spot bond market where bond participants suffer losses due to default of a trading counterparty. In both cases, the maximum claim per default is limited to the lower of five percent of the fund or ZAR 1 million.

#### **Recent experiences with failures**

Suspensions and withdrawals of licenses are imposed routinely without there being material concerns with respect to client losses. The FAIS Division is presently monitoring the curatorship of five firms where the client assets were put at risk. These liquidations are taking place in an orderly manner. The eventual losses expected to be incurred by clients vary across the cases, from very little (99 percent return expected) to much larger amounts.

The JSE has not had a failure of an equities member for 15 years. There was a failure of a derivatives member in 2008 as a result of the financial crisis. The firm had no clients in South Africa. The firm's proprietary positions were transferred to the clearing member that closed out those positions with no impact to the other market participants.

#### **Communications**

MOUs are in place with other regulatory authorities, which facilitate the communication and co-operation process between regulators locally and internationally. The FSB is also a signatory to the SADC and IOSCO MMOUs. See the discussion under Principle 13.

The JSE has authority under the FMA (section 73) and its own rules (e.g., Equities Rule

	<p>12.20) to share information with other regulators or exchanges and has entered into arrangements with a number of foreign exchanges to facilitate and promote cooperation between them.</p> <p>A SRO Incidence Committee, which consists of representatives of the JSE, Strate, FSB and SARB, is in place should the financial disruption be seen to raise systemic risk issues. The event may also be escalated to the FSCF, if required.</p> <p>In practice, if the JSE needs to communicate with the FSB, the established contacts are in place. If the JSE needs to communicate with a foreign regulator that communication would take place via the FSB's established co-operation arrangements with its foreign peers.</p>
Assessment	Broadly Implemented
Comments	<p>The authority of the FSB to take action when an FSP is in financial trouble is extensive and it has current experience in dealing with firm failure. However, there is no specific plan in place to address a failure, nor are there any mechanisms that would give the regulator warning of a decline in financial position until the capital requirements are actually breached. The downgrade for the missing early warning mechanism is taken into account in Principle 30.</p> <p>The JSE also lacks a specific early warning requirement, but this is less of a concern for JSE equity members, given the tight monitoring of those members' capital positions by the JSE. The JSE also does not have a written plan in place, but one is in development and both the JSE and Strate have clear default rules.</p>
<b>Principles for the Secondary Markets</b>	
<b>Principle 33.</b>	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p><b>Authorization of exchanges</b></p> <p>An exchange is defined in Section 1 of the FMA as a person that constitutes, maintains and provides an infrastructure for bringing together buyers and sellers of securities and for matching bids and offers for securities of multiple buyers and sellers, whereby a matched bid and offer for securities constitutes a transaction. An exchange is required to be licensed (Section 7(1) FMA). A juristic person may apply to the Registrar for an exchange license in respect of one or more types of securities (Section 7(2) FMA). The FMA includes general requirements applicable to all market infrastructures (i.e., exchanges, CSDs, clearing houses and trade repositories) and specific requirements applicable to exchanges.</p> <p>The JSE is currently the only licensed exchange in South Africa. Its license covers all securities as defined in Section 1 of the FMA. The JSE license was granted under the</p>

SSA, and when the FMA came into force, the JSE was not required to reapply. However, its rules had to be amended to comply with the FMA (Section 110(2) FMA).

The FMA does not recognize other types of trading systems. The FSB informed that if other trading systems (such as alternative trading systems) were to be set up in South Africa, the Registrar would likely use a proportionality principle in applying the FMA to such trading systems. This would be possible under Section 6(3)(m) of the FMA that enables the Registrar to grant an exemption from the provisions of the FMA, provided that it does not conflict with the public interest or frustrate the achievement of the objectives of the FMA. The FSB is currently considering the need to apply the FMA to systems where listed companies make a market in their own shares (either directly or through arrangements with third parties), since such platforms may qualify as exchanges under the FMA.

#### **Authorization requirements**

An applicant for exchange license and a licensed exchange must comply with the following requirements (Section 8(1) FMA):

- Have in South Africa assets and resources, including financial, management and human resources with appropriate experience to perform its functions as set out in the FMA;<sup>46</sup>
- Have governance arrangements that are clear and transparent, promote the safety and efficiency of the exchange, and support the stability of the broader financial system, other relevant public interest considerations, and the objectives of relevant stakeholders;
- Demonstrate that the fit and proper requirements prescribed by the Registrar are met by the applicant/exchange, its directors and senior management;
- Have made arrangements for the efficient and effective surveillance of all transactions effected through the exchange and for the supervision of authorized users so as to identify possible market abuse and ensure compliance with the exchange rules, exchange directives and the FMA;
- Have made arrangements for the efficient and effective monitoring of compliance by issuers of securities listed on the exchange with the exchange's listing requirements;
- Implement arrangements to efficiently and effectively manage the material risks associated with the operation of an exchange;
- Have made arrangements for efficient and effective security and back-up procedures to ensure the integrity of the records of transactions effected

<sup>46</sup> These requirements are due to be prescribed in regulations to be issued by the Minister of Finance. At the time of the assessment mission, the regulations had not yet been published.

	<p>through the exchange;</p> <ul style="list-style-type: none"> <li>• Have an insurance, guarantee, compensation fund or other warranty in place to enable it to provide compensation to clients;</li> <li>• Make arrangements for the efficient and effective clearing and settlement of transactions effected through the exchange and for the management of settlement risk;</li> <li>• Have made arrangements for the efficient and effective supervision of authorized users so as to ensure compliance with FICA; and</li> <li>• Implement an effective and reliable infrastructure to facilitate the trading of securities listed on the exchange.</li> </ul> <p>A Registrar is entitled to require an applicant or a licensed exchange to furnish such information, or require such information to be verified, as he/she may deem necessary to determine whether the applicant or the exchange meets the above requirements. Any other information regarding the applicant or the exchange derived from any source may also be taken into account, if such information is disclosed to the applicant or the exchange, giving it a reasonable opportunity to respond to it. (Section 8(2) FMA).</p> <p>According to Section 17 of the FMA, the exchange rules must be consistent with the FMA and include, among other issues, requirements in the following areas (in addition to the self-regulatory requirements described in Principle 9):</p> <ul style="list-style-type: none"> <li>• Circumstances in which a transaction in listed securities may be declared void by the exchange;</li> <li>• Approval by the exchange of an authorized user's nominee that holds securities in a securities account or central securities account in a central securities depository;</li> <li>• The conditions subject to which an officer or employee of an authorized user may advise on or conclude any transaction on behalf of an authorized user in the course of that authorized user's business and for the circumstances in which he/she may be denied access to the exchange;</li> <li>• Circumstances in which trading in any listed security may be suspended or halted;</li> <li>• Manner in which an authorized user is generally required to conduct its authorized securities services;</li> <li>• The operation by an exchange or authorized user of a trust account;</li> <li>• The manner in which authorized users must comply with the requirements for the recording of transactions effected through the exchange, for monitoring of compliance by authorized users with the exchange rules and exchange directives, and for surveillance of any matter relevant for the purposes of the</li> </ul>
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	<p>FMA, the exchange rules and the exchange directives;</p> <ul style="list-style-type: none"> <li>• Process whereby complaints by authorized users against the exchange in respect of the exercise of exchange functions may be made, considered and responded to;</li> <li>• The manner in which complaints against an authorized user or officer or employee of an authorized user must be investigated;</li> <li>• The manner in which an authorized user or its officer or employee may be required to appear before a person conducting an investigation, to be interrogated or to produce a document;</li> <li>• The purposes for which, and the process by which, an exchange may issue exchange directives: <ul style="list-style-type: none"> <li>• For supervisory measures that enable the exchange to comply with its obligation to supervise and enforce the authorized users' and issuers' compliance with the FMA and the exchange rules, directives and listing requirements;</li> <li>• For the authority of, the manner in, and circumstances under which: <ul style="list-style-type: none"> <li>• An exchange may limit the revocation of any settlement instruction given by an authorized user or its client;</li> <li>• On the commencement of insolvency proceedings, an authorized user or client may revoke any settlement instruction before the point in time when settlement instructions become irrevocable as determined in the exchange rules, but prior to settlement;</li> <li>• An exchange or an authorized user may terminate transactions on the commencement of insolvency proceedings.</li> </ul> </li> <li>• For the arrangements an authorized user must make for the administration of securities and funds held for its own account or on behalf of a client, including the settlement of unsettled transactions, under insolvency or default proceedings in respect of that authorized user.</li> </ul> </li> </ul> <p>More detailed requirements on the information required for the application for an exchange license are included in Board Notice 104 of 2013 (Requirements Applicable to the Granting of a Market Infrastructure License). Such information includes:</p> <ul style="list-style-type: none"> <li>• A copy of the proposed rules of the applicant, approved by the controlling body of the applicant;</li> <li>• A copy of the proposed listing requirements of the applicant, approved by the controlling body of the applicant;</li> <li>• Details pertaining to the trading method or facility by means of which the business of the exchange will be carried on;</li> </ul>
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	<ul style="list-style-type: none"> <li>• The range of securities proposed to be listed on the exchange; and</li> <li>• The range of investors, both local and foreign, expected to invest through the exchange.</li> </ul> <p><i>Prudential requirements</i></p> <p>According to Section 15 of the FMA, an exchange may impose a fee on any person involved in a transaction in listed securities affected through the exchange for the purpose of administering and maintaining the insurance, guarantee, compensation fund or other warranty. Any funds received or held by an exchange for this purpose are considered to be trust property as defined in the Protection of Funds Act, which applies to those funds.</p> <p>The exchange rules must include requirements for the insurance, guarantee, compensation fund or other warranty covering:</p> <ul style="list-style-type: none"> <li>• The persons who must contribute to maintain it;</li> <li>• The amount of the fee imposed by the exchange for this purpose;</li> <li>• The different categories of claims that may be brought against the insurance, guarantee, compensation fund or other warranty;</li> <li>• The restrictions on the amount of any claim;</li> <li>• The control and administration of the insurance, guarantee, compensation fund or other warranty; and</li> <li>• The ownership of the insurance, guarantee, compensation fund or other warranty.</li> </ul> <p>The application for authorization has to include details of such insurance, guarantee, compensation fund or other warranty. In respect of compensation funds, the application has to include a copy of the pro forma policy document, the manner of funding, and the rules of the fund (where applicable).</p> <p>An applicant for an exchange license must also provide sufficient proof that it has assets and resources in South Africa to perform its functions and duties. The detailed requirements will be set in the regulations to be prescribed by the Minister of Finance. In the case of the JSE, tailored requirements have been applied.</p> <p><i>Clearing, settlement and depository arrangements</i></p> <p>Under Section 10(2) of the FMA, a licensed exchange must make provision for the clearing and settlement of transactions in listed securities effected through the exchange. It must also consult with an appointed associated clearing house<sup>47</sup> when</p>
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<sup>47</sup> An associated clearing house is a clearing house that clears transactions in securities on behalf of one or more exchanges in accordance with the rules of the relevant exchange and that does not approve or regulate clearing members. SAFCOM acts as such an associated clearing house for the JSE.

making or amending the exchange rules in accordance with which the associated clearing house will clear or settle transactions on behalf of the exchange. If it has not appointed a clearing house to clear transactions on its behalf, it must establish and maintain an infrastructure for the clearing of transactions effected through the exchange and manage the clearing of transactions that the exchange rules determine will be cleared. The exchange rules must include requirements on the manner for clearing (if any) and settlement of transactions in listed securities and monitoring of the settlement obligations (where relevant).

The business plan of an applicant for exchange license has to include information on the clearing and settlement of transactions effected through the applicant and the management of settlement risk. The details pertaining to the settlement, custody and administration functions to be provided to the exchange and the arrangements in place for the clearing and settlement of transactions effected through the exchange and for the management of settlement risk have to also be described in the application.

*Market surveillance, member supervision, dispute resolution and appeal procedures*

An applicant's business plan has to include the following information:

- Plans to ensure the integrity of the market and its authorized users;
- The surveillance procedures, which have been established to ensure compliance with the exchange's proposed rules and directives and the FMA requirements as well as the resources of the applicant available to perform this function; and
- Procedures to be followed to effectively discipline the applicant's authorized users for non-compliance.

The application also has to describe the arrangements in place for the monitoring of compliance by issuers of securities listed on the exchange with the listing requirements, for the surveillance of all transactions effected through the exchange and for the supervision of authorized users so as to identify possible market abuse and ensure compliance with the exchange rules, exchange directives and the FMA.

*Technical system standards and procedures*

An applicant's business plan has to deal with the planned development of its information technology systems and infrastructure and arrangements for their supply, management, maintenance, upgrading and security. An application also has to include a report from the applicant's auditor to the effect that adequate systems and procedures are in operation relating to risk reduction, particularly by means of processing, physical and logical security, back-up and contingency controls. Details pertaining to the effective and reliable infrastructure to facilitate the trading of securities listed on the exchange and the arrangements in place for effective and efficient security and back-up procedures to ensure the integrity of the records of

transactions effected through the exchange need to be provided. Finally, the application has to include a report by an independent party, agreed to by the Registrar, confirming that the applicant has adequate systems, procedures and policies in place including a business continuity plan, a disaster recovery plan and the necessary service level agreements with third parties before the exchange related operations commence, as well as adequate disaster recovery hardware and related facilities located off-site.

*Ability to deal with disorderly trading conditions*

As noted above, Section 17 of the FMA requires that the exchange rules address circumstances in which trading in any listed security may be suspended or halted. In practice, the JSE's Equities Rules provide that the market controller may decide that the market or segments of the market in equity securities be paused, suspended, halted or closed, if he/she is of the opinion that a fair and realistic market does not exist. This may be deemed to happen on the basis of the percentage of members not able to access the JSE systems and their contribution to price formation and value traded. The market controller may also reduce or extend the hours of operation of the JSE equities trading system for any particular business day. He/she may also, without prior notice to any person, pause, suspend, halt or close the JSE equities trading system for trading at any time and for any period, as well as take such other steps as may be necessary to ensure an orderly market. (Paragraph 6.10.6 of the JSE Equities Rules).

According to Section 6.10.8 of the JSE Equities Rules, in order to maintain orderly price formation, the JSE equities trading system may incorporate circuit breakers in one or more segments of the market which, when triggered, will either cause the suspension of continuous trading and the commencement of an auction call session or the extension of an auction call session for the affected security or securities. The circuit breakers will be triggered when price movements exceed defined levels based on defined static and dynamic reference prices determined by the JSE. Each equity security is allocated to a segment based on certain characteristics, including the instrument type and the liquidity of the security. The dynamic circuit breaker in continuous trading is either 5 percent or 10 percent, depending on the segment, whereas the static circuit breaker is either 10 or 20 percent. The dynamic circuit breaker uses a dynamic reference price, which is normally the price of the last order book trade. The static circuit breaker's reference price at the beginning of a trading day is the previous trading day's closing price, which will be updated after each auction.

In addition, Section 6.80 of the JSE Equities Rules provides that the Director: Surveillance or his deputy, in conjunction with the Chief Executive Officer, acting Chief Executive Officer or the Director: Issuer Services, may declare a trading halt in an equity security in circumstances where the Director: Surveillance determines that the trading activity in an equity security is or could be undertaken by persons possessing unpublished price sensitive information that relates to that security, is influenced by a manipulative or deceptive trading practice, or may otherwise give rise to an artificial price for that equity security.

Similar requirements are included in Section 7.40.5.2 and 7.40.7 of the JSE IRC Rules (IRC Rules) and Sections 7.90.3.2 and 7.190 of the JSE Derivatives Rules.

#### *Record-keeping*

An applicant's business plan must describe the security procedures to ensure the integrity of the systems for recording transactions and the maintenance of records, the capacity of these systems in relation to the budgeted number of transactions and the back-up resources available in the event of a systems failure.

#### *Outsourcing*

The requirements on outsourcing (delegation) are in Section 68 of the FMA, according to which a market infrastructure may delegate or assign any function entrusted to it to a person or group of persons, a committee approved by the controlling body of the market infrastructure, or a division or department of the market infrastructure, subject to the conditions that the market infrastructure may determine. Before delegating or assigning functions to an external party, the market infrastructure must obtain the approval of the Registrar. A market infrastructure is not divested or relieved of a function delegated or assigned, and may, if necessary, withdraw the delegation or assignment at any time on reasonable notice.

#### **Application process**

According to Section 7(3) of the FMA, an application for an exchange license must:

- Be made in the manner and contain the information prescribed by the Registrar;
- Show that the applicant complies with the licensing requirements;
- Be accompanied by:
  - A copy of the proposed exchange rules;
  - A copy of the proposed listing requirements;
  - A copy of the founding documents of the applicant;
  - Such information in respect of the members of the controlling body of the applicant as may be prescribed by the Registrar; and
  - An application fee prescribed by the Registrar.
- Be supplemented by any additional information that the Registrar may reasonably require.

Section 7(4) of the FMA provides that the Registrar must publish a notice of an application for an exchange license in two national newspapers at the expense of the applicant, and on the official website. The notice must state the name of the applicant, where the proposed exchange rules and listing requirements may be inspected by members of the public, and the period within and the process by which objections to

the application may be lodged with the Registrar.

The Registrar may, after considering any objection received as a result of the above notice and subject to any appropriate conditions, grant an exchange a license, if the applicant complies with the relevant requirements of the FMA, and the objectives of the FMA will be furthered by granting the exchange license. An exchange license must specify its terms and conditions, the categories of securities that may be listed on that exchange, the registered office of the exchange in South Africa and the places where the exchange may be operated (Section 9 FMA).

#### **Admission of securities and market participants**

As noted above, the JSE's Listing Requirements are approved by the Registrar. Therefore he/she approves the rules governing the admission of the various types of securities to listing. The JSE has an internal process, where all products with a new product design are considered by the JSE's New Products Committee, which assesses whether the product is suitable for listing prior to the formal approval of the listing by the JSE's Executive Committee.

The exchange rules (that are subject to the Registrar's approval) also have to provide for equitable criteria for the authorization of authorized users (see above on Section 17 of the FMA).

#### **Order routing and order execution procedures**

The JSE Client Connectivity Standards and Requirements available on the JSE website describes the connectivity options and requirements to the various JSE markets. In practice, all JSE authorized users connect to the JSE equities trading system (Millennium) either using a dedicated Diginet line or a Telkom dial-up network. It is the authorized user's responsibility to ensure connectivity to the exchange.

In addition, the JSE has a point of presence in London that is designed to support distribution of JSE market data to clients in London and to enable trading on the JSE markets through a JSE member.

The JSE's colocation facility that allows customers to host their infrastructure in the immediate vicinity of the JSE trading engine was opened on May 12, 2014. After the introduction of the colocation facility, the JSE plans to disclose the average latency experienced by all trading system users. Before, the JSE only disclosed order execution response times to a market participant upon request.

The JSE order execution rules are described in its rules, directives and various documents available on the JSE website. For example, the user specification document Trading and Information Overview includes detailed information on the manner orders are entered into and trades are executed in the JSE equities trading system. The FSB does not review the trade matching algorithm, the fairness of which remains the responsibility of the JSE.

*Direct market access*

Directive B of the JSE's Equities Directives includes the requirements on direct market access provided by a TSP. A TSP is not permitted to operate an order entry application (OEA) that provides direct market access without the JSE's prior written approval. An OEA facilitates the electronic submission of orders by the TSP's controlled clients<sup>48</sup> or non-controlled clients,<sup>49</sup> or both, and is provided on the condition that the member ensures at all times that the OEA meets the following key objectives:

- The OEA must ensure that orders are not submitted to the JSE equities trading system or left open in the trading system, if such orders could result in erroneous trades, a false appearance of trading activity or an artificial price for a security;
- Adequate controls must be implemented to ensure that orders are within the normal trading patterns of the relevant clients. The OEA should also be able to limit the life of an order and be able to control each of the relevant order types;
- The OEA must be able to verify, before submitting any orders to the JSE equities trading system, the capacity of the client to settle trades resulting from orders processed via the application, through the use of appropriate exposure limits for non-controlled clients and checks on availability of funds and securities for controlled clients;
- The OEA must be able to detect and react to the various JSE defined trading sessions;
- The OEA must be able to identify the source of all order details submitted to the JSE equities trading system and must ensure and be able to evidence the maintenance of the integrity of the order details from the receipt of an order by the member to the submission of the order to the JSE equities trading system;
- All orders submitted to the JSE equities trading system by the OEA and the trades resulting from those orders must comply with the requirements of the rules and directives; and
- The technical specifications of the OEA must comply with the JSE User Specification Documentation and must ensure that the operation of the application will not adversely impact the operation of the market. Access to the application software and the data utilized by that software must be strictly controlled to prevent undue manipulation.

<sup>48</sup> A controlled client means a client or an account holder on whose behalf a client is acting, whose funds and uncertificated equity securities are under the control of a CSP or whose settlements take place via the CSD participant of a member.

<sup>49</sup> A non-controlled client means a client or an account holder on whose behalf a client is acting, who has appointed his own CSD participant to settle transactions in equity securities on his behalf.

	<p>The JSE may request such information from a TSP as the JSE deems necessary to monitor the usage by members and their clients of OEAs that provide direct market access and to assess the effectiveness of the measures implemented by the members to control the use of such applications on an ongoing basis. However, it does not inspect the systems.</p> <p>A TSP that operates or intends to operate a member trading application or any other system that generates proprietary orders to be submitted to the JSE equities trading system without the intervention of a registered securities trader, may be required to submit such information to the JSE as is deemed necessary to satisfy the JSE that the TSP meets or will meet the requirements in the JSE Rules and Directives relating to the submission of orders to the JSE equities trading system.</p> <p>A TSP that operates an OEA that provides direct market access or a member trading application that automatically generates orders for the member's own account must ensure that the JSE allocates one or more trader identification numbers to the member in respect of such systems to facilitate the identification of orders processed by such systems as being DMA orders or automated proprietary orders. In requesting the JSE to allocate a trader identification number in respect of a member trading application that automatically generates orders for the member's own account, a member may be required to provide the JSE with information regarding the manner in which orders are generated by the application. This information assists the JSE in identifying those applications that may, in certain circumstances, generate an excessive number of orders which may adversely impact the operation of the JSE equities trading system.</p> <p><b>Access to trading information</b></p> <p>Members are able to subscribe to all order and trade data on a real-time basis. The JSE systems disclose only public data. Private member data is made available only to the JSE, and confidential client data is made available only to the JSE market regulation staff.</p>
Assessment	Fully Implemented
Comments	
<b>Principle 34.</b>	There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p><b>Market surveillance</b></p> <p><i>JSE</i></p> <p>The JSE has a real-time market surveillance system and a staff of three for monitoring equities trading, two for derivatives trading and three for bond trading. The JSE's BDA</p>

system, to which all equity trading members are connected, identifies the first level client that trades through a member. The JSE market surveillance systems provide a functionality to flag unusual trading patterns and the JSE staff have the authority to immediately contact listed companies (issuers) and authorized users (members) for information or explanations of unusual trading or company activities. The JSE applies stricter surveillance for its equities markets than for its derivatives markets, since it considers market surveillance to be more important in the equities markets than in the primarily wholesale derivatives markets.

The JSE is in the process of replacing some of its systems with more reliable and scalable systems. It recently renewed its trading system, and is in the process of renewing its market surveillance system.

#### *FSB*

The FSB does not currently conduct any real-time market surveillance. Instead, the DMA staff meets every two weeks with the JSE Surveillance Department to discuss trading anomalies and possible market abuse practices that require further investigation by the FSB. During these meetings, an FSB employee examines trading in the JSE shares during the past two weeks. The FSB can access the JSE surveillance systems at any time at the offices of the JSE.

#### **Member supervision**

#### *JSE*

Section 12.10 of the JSE Equities Rules covers surveillance and investigations by the JSE Surveillance Department. The rules provide that:

- The department may set up and maintain systems for:
  - Monitoring compliance by members with the FMA, the rules and the directives;
  - The surveillance of any matter relevant for the purposes of the FMA, the rules and the directives; and
  - Supervising compliance by members with FICA.
- The Director: Surveillance, and any other person designated by him, may:
  - Investigate any JSE related activities of any person who at the relevant time was a member or an employee of a member;
  - Investigate whether a member or any of its employees complies with the FMA, the exchange rules, the exchange directives and FICA;
  - Investigate whether a member is trading in such a manner that there is a danger that it may not be able to meet its commitments to clients, other members or a settlement system;
  - Investigate whether a member is conducting its business in a manner which

	<p>could be detrimental to the interest, good name or welfare of the JSE or its members; and</p> <ul style="list-style-type: none"> <li>Require any person who is subject to the jurisdiction of the JSE to furnish any information or to produce a book, document, tape or electronic record or other object that has a bearing on the subject of the investigation or to appear at a specified time and place to be questioned or to furnish or provide the above mentioned information or data.</li> </ul> <p>Any information or data obtained by the JSE Surveillance Department may be used in evidence in any disciplinary proceedings and may be furnished by the JSE Surveillance Department to any other body that may have jurisdiction over the matter. If the JSE Surveillance Department becomes aware of any contravention of law by a person over whom the JSE does not have jurisdiction, it may refer such matter to the appropriate authority or authorities.</p> <p>Principle 31 describes in more detail the implementation of the JSE supervisory program.</p> <p><i>FSB</i></p> <p>The FSB does not authorize or supervise exchange members, other than where they also carry on activities requiring separate licensing as FSPs as described in Principles 29-31.</p> <p><b>FSB supervision of the JSE</b></p> <p><i>Ongoing supervision</i></p> <p>The Registrar or a person nominated by him/her may attend any meeting of the controlling body of a market infrastructure or a committee of the controlling body, and may take part, but may not vote, in all the proceedings at such meeting (Section 70 FMA). In practice, the FSB staff attend all JSE Board and Board subcommittee meetings as observers. The FSB Executive Officer normally represents the FSB at the JSE Board meetings. In the past the FSB staff also attended the meetings of the JSE Executive Committee, but this practice was discontinued primarily to avoid the perception of regulatory capture. Due to the frequency of the Executive Committee meetings, regular participation also had resource implications on the Capital Markets Department.</p> <p>The FSB staff also attend the meetings of the JSE Advisory Committees (e.g., Trading Advisory Committee) and participate in various ad hoc working group meetings organized by the JSE. Regular bilateral meetings are also organized between the relevant staff of the FSB and the JSE.</p> <p>The FSB representatives at the various meetings prepare an internal report from each meeting attended.</p> <p><i>Reporting</i></p> <p>The FMA includes certain formal reporting requirements applicable to the JSE. Within</p>
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four months after the financial year end, a market infrastructure must submit to the Registrar an annual report containing the details prescribed by the Registrar and its audited annual financial statements (Section 69 FMA). Board Notice 101 of 2013 sets out the information that must be contained in this annual report:

- A list of JSE Board and Executive Committee members and authorized users and any changes to them over the last financial year;
- A report signed by the chairperson and Chief Executive Officer reviewing the operations of the JSE over the last financial year;
- An auditor's report on the annual financial statements;
- A summary of market information which must reflect the salient features of the trading, settlement or other activities, as applicable, of the market infrastructure;
- A report detailing the JSE's initiatives and plans to implement the recommendations of the most recent King III Code;
- A status report on the JSE's consumer education initiatives, if any;
- A status report on the JSE's initiatives, if any, in the SADC region;
- A report on operational risk mitigation, operational integrity and related issues;
- A list of the securities services that have been authorized and that are regulated by the JSE in respect of authorized users;
- A report on the number, nature and status of complaints lodged against the JSE by authorized users under the exchange rules during the last financial year; and
- The results of the annual assessment of the market infrastructure.

The requirement for the above mentioned annual assessment is based on Section 62(b) of the FMA that requires that a market infrastructure must, where applicable, take necessary steps to avoid, eliminate, disclose and otherwise manage possible conflicts of interest between its regulatory functions and its commercial services. Such steps must include the implementation of appropriate arrangements that comply with the requirements prescribed by the Registrar and are documented and publicly available and an annual assessment, in the manner prescribed by the Registrar, of these arrangements, the results of which must be published.

Board Notice 95 (Conditions Applicable to the Inclusion by an Exchange of Securities Issued by It in Its Own List) requires an exchange to include in its annual report to the Registrar a section on the regulatory and supervisory structure applicable to, and the role of the Registrar in supervising, the exchange's own listing, which section must include:

- A statement to the effect that in the opinion of the controlling body, the

	<p>exchange has complied with all its rules, listing requirements and procedures in a manner which warrants the continued listing of the exchange's securities on the exchange;</p> <ul style="list-style-type: none"> <li>• A confirmation that all complaints relating to a conflict of interest were referred to the Registrar during the year under review; and</li> <li>• The results of its annual assessment under Section 62(b) of the FMA.</li> </ul> <p>The above requirement is new, and no such assessment has yet been made (see Principle 9).</p> <p>The JSE must also furnish the Registrar with all notices, minutes and documents which are furnished to its Board or Board Committee members, as if the Registrar were a member of the Board or Board Committee (Section 70(2) FMA).</p> <p>Starting a few years ago, the JSE is also required to complete an annual self-assessment on the basis of a questionnaire prepared by the FSB. The 2013 self-assessment included sections on the Board, Executive Committee, supervision of authorized users, supervision of issuers, as well as supervision of market movements and market abuse.</p> <p><i>On-site visits</i></p> <p>Section 59 of the FMA requires that the Registrar annually assesses, whether a licensed market infrastructure complies with the FMA, the Registrar's directives, requests, conditions and requirements as well as its own rules and whether it gives effect to the Appeal Board decisions made under Section 105 of the FMA.</p> <p>In practice, the FSB conducts an annual on-site visit of the JSE focusing on issues identified through the self-assessment. In the past there has been one such review per year. During the current financial year, the FSB plans to conduct two such reviews.</p> <p><i>Rule approval</i></p> <p>As noted in Principle 9, the FSB approves the JSE rules and listing requirements. It also receives the JSE Directives for comments, but does not approve them.</p> <p>Section 71 of the FMA deals with the process for amending the exchange rules by both the exchange itself and the FSB. It provides that a market infrastructure may amend or suspend its rules in accordance with the consultation process set out in the rules. The Registrar may also amend the rules or issue an interim rule. This process is described in more detail in Principle 4.</p> <p><b>Enforcement by the FSB</b></p> <p>The Registrar has a range of powers at its disposal in case of a need to enforce the requirements of the FMA vis-à-vis an exchange.</p> <p>Section 6(3)(h) of the FMA provides that the Registrar may impose conditions that are consistent with the FMA in respect of any license, authorization, approval, consent or</p>
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	<p>permission granted by the Registrar, and may amend or withdraw such conditions at any time. Under Section 6(4)(a) of the FMA it may also, in order to ensure the implementation and administration of the FMA, compliance with the FMA or achievement of the objectives of the FMA, issue a directive to the exchange to implement specific practices, procedures or processes, to take specific actions or measures, to desist from undertaking specific practices, procedures, processes, actions or measures, or to prohibit certain practices, procedures, processes, actions or measures.</p> <p>The Registrar may assume responsibility for one or more of the regulatory or supervisory functions of a licensed exchange, if the Registrar considers it necessary in order to achieve the objectives of the FMA (Section 10(3)(a) FMA).</p> <p>Finally, the Registrar may cancel or suspend the license of an exchange if:</p> <ul style="list-style-type: none"> <li>• The exchange has failed to comply with the FMA or its rules, comply with a directive, request, condition or requirement of the Registrar, or give effect to a decision of the Appeal Board; or</li> <li>• After an inspection of the affairs of the exchange, the Registrar is satisfied on reasonable grounds that the manner in which the exchange is operated is not in the best interests of authorized users and their clients or defeats the objectives of the FMA.</li> </ul> <p>In practice none of the above enforcement measures have been applied to the JSE.</p>
Assessment	Fully Implemented
Comments	
<b>Principle 35.</b>	Regulation should promote transparency of trading.
Description	<p><b>Pre-trade transparency</b></p> <p>The pre-trade transparency requirements applicable to trading at the JSE are included in the JSE rules. With regards to equities trading, the JSE Equities Rules require that all transactions in equity securities by a member must be conducted through the central order book of the JSE equities trading system, unless the transaction meets the criteria for an off-book trade. Orders entered into the central order book are matched based on the following order of priority: price, whether the order is visible to the market, and time of entry into the central order book.</p> <p>The JSE equities trading system has one order type that is not visible to the market. This hidden limit order has no visible size, but its underlying quantity must be greater than or equal to a minimum reserve size at the time of submission of the order and it must have a minimum execution size. The minimum reserve size is determined by the market controller per equity security and published in the JSE Gazette.</p>

It is also possible to conduct certain off order book trade types within the exchange system without pre-trade transparency. The following table (Section 6.30.5 of the JSE Equities Rules) lists such trade types and indicates whether the transaction may be conducted by one member or two members and whether the transaction is published by the JSE.

#### JSE Off Order Book Trade Types

Transaction description	Single member	Two members	Published
Bookbuild Trade	No	Yes	Yes
Block Trade	Yes	Yes	Yes
Corporate Finance Transaction	Yes	Yes	Yes
Delta Trade	No	Yes	No
Exercise of Options	Yes	Yes	No
Exercise of Traded Options	Yes	Yes	No
Exercise of Warrants	Yes	Yes	No
Give-up Trade	No	Yes	No
Late Trade	Yes	No	Yes
Off Order Book Principal Trade	Yes	No	Yes
Portfolio Transaction	Yes	Yes	Yes
Next Day Cancellation of On Book Trade	Yes	Yes	Yes
Next Day Cancellation of a published Off Book Trade	Yes	Yes	Yes
Next Day Cancellation of a non-published Off Book Trade	Yes	Yes	No

Source: JSE Equities Rules.

The above off order book trade types are common in exchanges that require members to report all trades to the exchange. The following are examples of the conditions for conducting some of the above off order book trade types:

- Block trade: A block trade is a transaction where a member trades as an agent or a principal in a single equity security and the transaction has a minimum value of ZAR 5 million and comprises at least twenty times exchange market size;
- Corporate finance transaction: A corporate finance transaction is a transaction which must be entered into in writing, requires public notification in the press and complies with the relevant requirements of the JSE Listing Requirements;
- Off order book principal trade: An off order book principal trade is a transaction where a member trades as a principal in a single equity security where the transaction has a minimum value of ZAR 500,000 and comprises at least six times the exchange market size, except where the transaction is with a foreign professional market participant in which case no minimum value or quantity of equity securities will apply; and
- Portfolio transaction: A portfolio transaction is a transaction where a member

	<p>trades as an agent or principal in a list of equity securities which has a minimum value of ZAR 15 million and comprises at least 10 different equity securities none of which exceeds 25 percent of the total value of the portfolio;</p> <p>According to the JSE, the proportion of order book trading varies between 80 and 95 percent depending on the share in question.</p> <p><b>Post-trade transparency</b></p> <p>There are no specific regulatory requirements regarding the dissemination of post-trade information to market participants. The JSE trading system does not permit delayed publication of post-trade information even for the above mentioned off order book trades.</p> <p><b>Information on and monitoring of dark trading</b></p> <p>The requirements for the hidden limit order and the off order book trade types are clearly described in the JSE Rules, Directives and other documentation available to both JSE members and to the public on the JSE website. The JSE has access to all hidden orders entered into the order book and off order book trades. The FSB would also have access to this information upon request.</p>
Assessment	Fully Implemented
Comments	
<b>Principle 36.</b>	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p><b>Prohibition of market abuse</b></p> <p>Inside information is defined in Section 77 of the FMA as specific or precise information, which has not been made public and which is obtained or learned as an insider and which, if it were made public, would be likely to have a material effect on the price or value of any security listed on a regulated market. An insider means a person who has inside information through being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates, or having access to such information by virtue of employment, office or profession. An insider is also a person who knows that the direct or indirect source of the information was a person in the above mentioned capacity (Section 77 FMA).</p> <p>Insider trading in securities and derivatives listed on a regulated market<sup>50</sup> to which the insider information relates or which are likely to be affected by it and disclosure of such information is prohibited in Section 78 of the FMA.</p>

<sup>50</sup> A regulated market means any market, domestic or foreign, which is regulated under the laws of a country in which the market conducts business as a market for dealing in securities listed on that market.

Market manipulation (together with other inappropriate trading practices, such as wash trading) is prohibited in Section 80 of the FMA. More specifically, Section 80 provides that no person may, either for such person's own account or on behalf of another person, knowingly directly or indirectly use or participate in any practice that has created or is likely to have the effect of creating an artificial price for a particular security or a false or deceptive appearance of the demand for, supply of, or trading activity in a security.

Making or publishing false, misleading or deceptive statements, promises and forecasts in respect of securities traded on a regulated market or in respect of the past or future performance of a company whose securities are listed on a regulated market is prohibited in Section 81 of the FMA.

A front running prohibition applies to FSPs (see Principle 31), but there is no specific prohibition of front running applicable to the JSE members. According to the JSE, the insider trading prohibition would enable it to investigate front running. If the FSB can prove that the offender traded on the basis of non-public price sensitive information, it can enforce front running as insider trading.

### **Monitoring**

As noted in Principle 33, an applicant for an exchange license is required to have made arrangements for the efficient and effective surveillance of all transactions effected through the exchange and for the supervision of authorized users so as to identify possible market abuse and ensure compliance with the exchange rules, the exchange directives and the FMA.

The JSE Equities Rules (Section 7.10) impose obligations on the JSE members to prevent and detect market abuse. A member is required to consider the circumstances of the orders placed by its clients before entering them in the JSE equities trading system. It must take reasonable steps to satisfy itself that such orders and any resultant trades will not result in a breach of Section 80 of the FMA. A member must ensure that all of its employees who receive orders from clients and execute transactions on the JSE equities trading system are familiar with the market abuse provisions in Sections 77-80 of the FMA and that those employees receive adequate training and guidance to enable them to recognize and avoid entering into any transaction on behalf of the member or its clients which will result in, or is likely to result in, a breach of those provisions.

A member's compliance monitoring procedures must specifically include procedures to monitor orders entered into, and transactions executed on, the JSE equities trading system by the member and its employees, with the objective of identifying and taking appropriate action in relation to orders or trades that, in the reasonable opinion of the member, may constitute a breach of Sections 78-80 of the FMA. Such procedures should, as a minimum, aim to detect activity which, to a reasonable person observing or reviewing such activity, would constitute a blatant breach of Sections 78 and 80 of

the FMA taking into account all relevant factors.

JSE's market surveillance activities are described in Principle 34.

### **Enforcement**

#### *FSB*

The administrative sanctions applicable to insider trading and disclosure of insider information can be at most (Section 82 FMA):

- The equivalent of the profit made or the loss avoided;<sup>51</sup>
- An amount of up to ZAR 1 million, to be adjusted by the Registrar annually to reflect the Consumer Price Index, as published by Statistics South Africa, plus three times the profit made or loss avoided;
- Interest; and
- Costs of the suit, including investigation costs, on such scale as determined by the EC.

In addition, the FSB may also make a compensation order under Section 82(4)-(7) of the FMA. Any amount recovered as a result of the administrative proceedings must be deposited directly into a designated trust account. The FSB is, as a first charge against the trust account, entitled to reimbursement of all expenses reasonably incurred by it in bringing such proceedings and in administering the distributions made to claimants. The balance, if any, must be distributed by the claims officer to the claimants that comply with the requirements set out in Section 82(5) of the FMA.

In addition, the EC of the FSB may impose additional penalties under the Protection of Funds Act (see the discussion in Principles 11 and 12).

The number of market abuse cases investigated by the FSB (on the basis of referrals from the JSE) that led to an administrative sanction in 2011-2013 is as follows:

<b>Number of Administrative Sanctions from Market Abuse Cases</b>				
	2011	2012	2013	Total
Insider trading	1	1	4	6
Market manipulation	1	3	2	6
Misleading information	0	0	1	1

Source: FSB.

In the above cases, the FSB has imposed in total the following administrative sanctions:

- Insider trading: total fines of ZAR 2,367,580 for six respondents,

<sup>51</sup> This includes also a profit that would have been made if the person would have sold the securities at any stage.

- Market manipulation: total fines of ZAR 29,750,000 for nine respondents; and
- Publication of misleading information: total fines of ZAR 965,000 for three respondents

In addition, in 2014 administrative sanctions were imposed in two market manipulation cases.

#### *Criminal process*

A person who commits a criminal offence referred to in Sections 78, 80 or 81 of the FMA, is liable on conviction to a fine not exceeding ZAR 50 million or to imprisonment for a period not exceeding 10 years, or to both such fine and such imprisonment (Section 109 FMA).

There has been only one criminal sanction for market abuse (fraud) in South Africa.

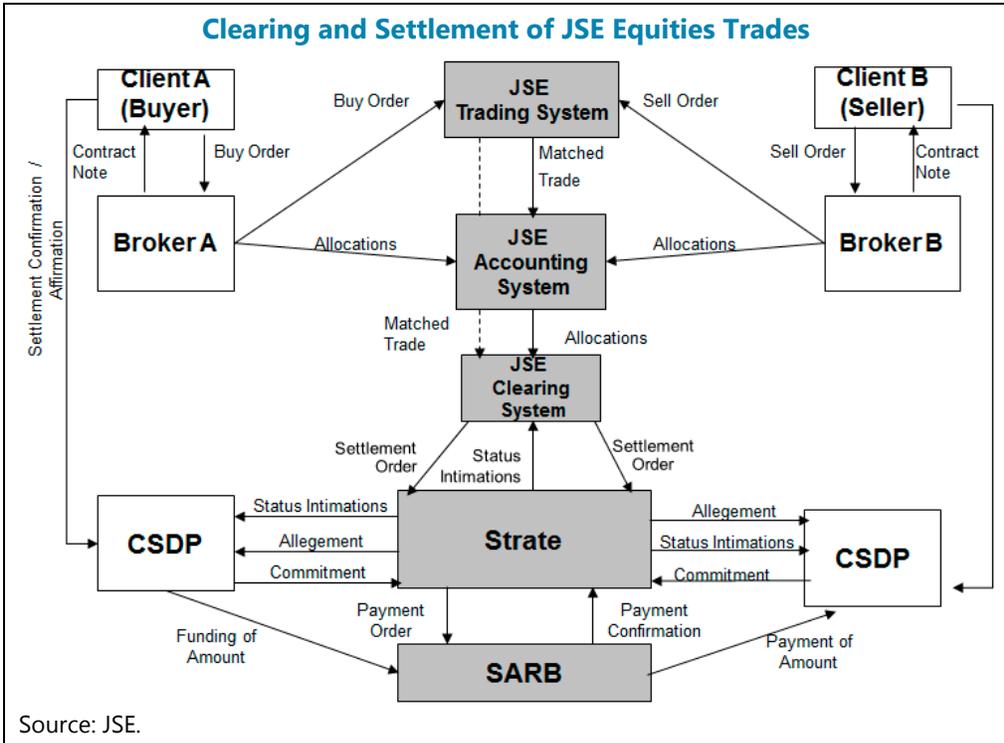
#### **Cross-market trading**

It is possible to trade in the JSE trading system only through a local member. Through the BDA system, the JSE has access to each member's first level clients' trading information. If these clients are foreign, further investigation is conducted by the FSB than can request information from foreign regulators under the IOSCO MMOU or the relevant bilateral MOUs.

According to the JSE Derivatives Rules, the clearing house may limit the aggregate exposure arising from the proprietary positions of a clearing member, the positions of the clients of the clearing member, the positions of trading members with which the clearing member has entered into clearing agreements and the positions of the clients of such trading members in relation to the net financial worth of the clearing member plus its suretyship in a manner determined by the JSE. A member must at all times maintain records of its trades with members and clients.

The JSE may at its discretion request trading members or clients to provide it with written statements in relation to agricultural derivative positions owned, controlled or carried by the trading member or a client of the trading member. On receipt of a written request from the JSE, a trading member or client must within two business days, furnish the JSE with a written statement in the form, manner and content prescribed by the JSE. Statements submitted to the JSE must include information necessary to enable the clearing house, or any person or committee authorized by the JSE to make a determination as to whether the relevant position of a trading member or client should be limited or reduced in terms of this rule.

No trading member or client may hold or control positions separately or in combination, net long or net short for the purchase or sale of a commodity for future delivery or options on a commodity on a futures equivalent basis, in excess of the limits as set out in the directives.

Assessment	Broadly Implemented
Comments	<p>Even though the JSE and FSB have been reasonably successful in detecting, investigating and sanctioning market abuse, it would be important to ensure that in addition to administrative enforcement, criminal enforcement is used to combat market abuse. The FSB, the SAPS and the NPA have enhanced their cooperation in this regard, but more work remains to be done to ensure that criminal enforcement becomes an effective additional deterrent to combat market abuse.</p> <p>The FMA prohibition of insider trading is limited to listed securities and derivatives. Therefore, insider trading in an unlisted derivative that has a listed security or derivative as an underlying instrument does not seem to be prohibited. Even though such a requirement is not required to comply with Principle 36, the authorities are encouraged to consider filling this gap in the future FMA amendments.</p>
<b>Principle 37.</b>	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	<p><b>Clearing and settlement of JSE trades</b></p> <p><i>JSE equities trades</i></p> <p>The following figure presents the equities clearing and settlement process for trades made in the JSE equities trading system:</p>  <p>The flowchart illustrates the clearing and settlement process for JSE equities trades. It starts with Client A (Buyer) and Client B (Seller) placing orders through Broker A and Broker B respectively. These orders are processed by the JSE Trading System, which identifies a Matched Trade. This trade is then recorded in the JSE Accounting System, which provides Allocations to both Broker A and Broker B. The JSE Accounting System also feeds into the JSE Clearing System. The JSE Clearing System sends Settlement Orders to Strate and Status Intimations to the CSDP. Strate, in turn, sends Settlement Orders to the CSDP and Allocations to SARB. SARB provides Funding of Amount to the CSDP and Payment Confirmation to Strate. The CSDP also provides Commitment to Strate. Finally, SARB provides Payment of Amount to the CSDP. The CSDP sends Settlement Confirmation / Affirmation back to Broker A and Broker B, which then provides Contract Notes to Client A and Client B respectively.</p> <p>Source: JSE.</p> <p>Equity trades settle at T+5 at Strate through the Strate's South African Financial</p>

Instruments Real Time Electronic Settlement (SAFIRES) system.

### *JSE derivatives trades*

The following figure presents the clearing of derivatives trades made at the JSE. The clearing of these trades is undertaken by SAFCOM. SAFCOM has mandated the JSE (functionally the JSE Clearing and Settlement Division) to perform its operational functions and risk management.



General clearing members (GCMs) of SAFCOM clear for themselves, non-clearing members and investors. Direct clearing members (DCMs) clear for themselves and investors. Non-clearing members, which are also referred to as trading members, appoint a GCM to clear for them.

### **Monitoring of large exposures**

All JSE equities members' trades in listed securities and listed derivatives are automatically entered into the JSE BDA system. In addition, the members have to separately report all their OTC derivatives trades to the BDA system. These entries identify the first level client of each trade, which provides the JSE with data on customer trading in cash equities that can be analyzed across more than one firm. It enables the JSE to identify large customer positions, unusual trading patterns, and large open positions, long or short. Therefore the JSE has the capacity to identify some beneficial owners trading large positions in its listed equity market.

The JSE Surveillance Department is responsible for monitoring on a daily basis members' large exposures, which attract a higher capital requirement. Section 11 of the JSE's Equities Directives places an obligation on a member to calculate its total Large Exposure Requirement (LER) arising from large exposures to third parties or groups of connected third parties.

Section 5 of the JSE's Derivatives Directives and Rule AA5 of the JSE's IRC Directives stipulates a similar manner for calculating a member's large exposure requirement.

Members not exempted (banks are automatically exempted) must include a declaration

of their large exposure risk in their monthly capital adequacy return.

If members are unable to meet their capital adequacy requirements due to large exposures or any other reasons, the JSE has the power to compel the member to reduce its exposures or provide additional capital.

According to Section 4.20.9 of the JSE Derivatives Rules and Section 3.40.10 of the JSE IRC Rules, the JSE is entitled to suspend a member, if there is a deficiency in the capital adequacy of the member.

See the discussion in Principle 30.

### **Managing risks from open positions**

The following focuses on JSE equities and derivatives trading, since bond trades are in practice only reported to the JSE system.

#### *Equities trading*

The JSE as a Settlement Authority manages the risk arising from open positions in equity trading through margin requirements, if the trading member does not have the securities/funds available for settlement or a CSD participant of Strate has not committed to settle the client's trade within a certain period after the trade day. More specifically, a JSE member is required to provide margin to the JSE in respect of its own or its clients' unsettled transactions in equity securities before 12:00 pm on the fourth business day after the trade (T+4):

- In respect of a non-controlled client transaction where, by end of day on T+3, the CSD participant of the non-controlled client has not committed to settle the transaction on behalf of that client;
- In respect of a controlled client sale transaction where, by end of day on T+3, the controlled client:
  - Does not have sufficient equity securities in the custody of the member or the member's CSP for the transaction to settle on settlement date;
  - Has not entered into a securities borrowing arrangement to facilitate the settlement of the sale on T+5, as reflected on the BDA system; or
  - Has not concluded a purchase transaction, which is due to settle on or before T+5 and which will provide sufficient equity securities for the sale to settle.
- In respect of a controlled client purchase transaction where, by end of day on T+3, the controlled client:
  - Does not have sufficient funds in the custody of the member or the member's CSP for the transaction to settle on T+5; or
  - Has not concluded a sale transaction which is due to settle on or before

	<p>T+5 and which will provide sufficient funds for the purchase to settle.</p> <ul style="list-style-type: none"> <li>• In respect of a sale transaction for the member's own account where, by end of day on T+3, the member: <ul style="list-style-type: none"> <li>• Does not have sufficient equity securities available for the transaction to settle on T+5;</li> <li>• Has not entered into a securities borrowing arrangement to facilitate settlement of the sale on T+5, as reflected on the BDA system; or</li> <li>• Has not concluded a purchase transaction which is due to settle on or before T+5 and which will provide sufficient equity securities for the sale to settle.</li> </ul> </li> <li>• In respect of a purchase transaction for the member's own account where the member has not concluded a sale transaction due to settle on T+5, which will provide sufficient funds for the purchase to settle on T+5.</li> </ul> <p>Margin is calculated in accordance with the principles set out in JSE Directives. To the extent that margin payable by a member relates to transactions on a client's account, the member may recover such margin from the client. The member must refund the client forthwith upon the repayment of margin to the member by the JSE.</p> <p><i>Derivatives trading</i></p> <p>The risk from open positions in derivatives trading is managed through margin requirements. The JSE Derivatives Rules require initial margin to be paid to or by a member or client whenever the risk of loss, as determined by the JSE, changes with respect to the aggregate position of such member or client. Variation margin must be paid as the result of the marking-to-market of a position to or by a member or client, in whose name a position in an exchange contract is registered. A clearing member may require a trading member with whom he has entered into a clearing agreement to deposit with him, with respect to the proprietary position of the trading member or the position of any of the clients of the trading member, an amount of additional margin as agreed upon between the parties in the clearing agreement. A member may require a resident client to deposit with him, with respect to the resident client's position, an amount of additional margin as agreed upon between the parties in the client agreement. The same requirements are included in the JSE IRC Rules for futures and options contracts. (JSE Derivatives Rules and JSE IRC Rules 8.50 and 8.60).</p> <p>The amount of variation margin to be paid is determined at 5 pm on each business day or at such other time as the JSE may determine by marking to market all members' and their clients' positions in each exchange contract. The marking to market may also take place at any other time at the discretion of the JSE or SAFCOM. Where a client of a derivative member or a non-clearing derivative member carrying on large positions is unable to fulfill its obligations in terms of a trade or a position, the JSE can, acting through a clearing member for the non-clearing member and a non-clearing member</p>
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for the client, require a reduction in exposures. The JSE does not have the power to directly compel clients of member firms to reduce exposures or post margins.

#### *Sharing of information*

The JSE would be able to share information on common market participants with foreign market operators or foreign regulators through the FSB's information sharing agreements with its international peers.

#### **Default procedures**

Section 17(2)(z)(cc) of the FMA requires the exchange rules to provide for the issuance of exchange directives for the arrangements in relation to the administration of securities and funds an authorized user holds, including the settlement of unsettled transactions under insolvency or default proceedings applicable to that authorized user.

#### *Equities market*

The default procedures in the JSE equities market are included in Section 13 of the JSE Equities Rules. A member will be in default, if it is unable to meet its commitments to another member, the JSE, a JSE settlement system or a non-member, arising out of a transaction or a JSE settlement system instruction. The JSE may also, in its sole discretion, consider that a member has defaulted. Once a member has been declared to be in default, its membership will be provisionally terminated. Upon a member being declared to be in default, the member will be suspended from trading, any amount payable by the JSE to the member will be set off against any amount payable by the member, and the member has to hand over to the JSE such financial records as the Director: Surveillance deems necessary to identify, protect and return client assets and to facilitate the settlement of outstanding transactions in equity securities as well as the control of all client assets.

The transactions of the defaulting member will be closed as follows:

- The JSE will use its best endeavors to procure that all open transactions conducted in the central order book between the defaulting member and other members and non-members are settled;
- In procuring settlement of these open transactions, the JSE will require clients of the defaulting member to meet their settlement obligations in respect of all open transactions executed on their behalf;
- Where possible, any funds or equity securities held by the defaulting member or its CSP on behalf of controlled clients or received by the defaulting member or the JSE from controlled clients subsequent to the default, which are required to effect settlement of open transactions conducted on behalf of those clients, will be applied by the JSE to settle such transactions;
- In attempting to procure that open transactions are settled, the JSE will be

entitled to buy in or sell out equity securities which cannot be either delivered or paid for by the defaulting member or its client, in those instances where the Settlement Authority is able to, and deems it appropriate to, procure the settlement of a transaction by means of the borrowing of equity securities or funds;

- If the JSE is unable to procure the settlement of any open transactions, the failed trade procedures in Sections 10.110-10.130 of the JSE Equities Rules will be applied.

The failed trade procedures can lead to cancellation of the original transaction between the failing party and a non-failing party and the non-failing party conducting a new transaction. The JSE will compensate any financial prejudice suffered by the non-failing member utilizing the margin held in respect of the failing member.

If a member will not be able to settle a sale transaction on settlement date, the Settlement Authority will endeavor to borrow, as agent, on behalf of the member as undisclosed principal, the equity securities required by the member to comply with its obligations to settle the transaction. The Settlement Authority may also lend to the member the funds required by the member to comply with its obligations to settle a purchase transaction.

#### *Derivatives market*

The default procedures in the JSE derivatives market are included in Section 12 of the JSE Derivatives Rules. A member will be in default, if it fails to fulfill any of its obligations in terms of a trade or a position, its membership is terminated, or the JSE, in its sole discretion, considers that it has defaulted. In the event of default by a trading member it will be suspended from trading and the trading member's clearing member will close out the proprietary positions of the trading member by trading to transfer those positions to itself. Any amount payable to the trading member as a result of such close-out will be set off against any amount payable by the trading member and any shortfall remaining after the application of these rules will be recovered from and any balance paid to the trading member. The clearing member must contact the clients of the defaulting member immediately to inform them of the default and to make arrangements for the transfer of existing client positions to the trading division of the clearing member or to another trading member.

In the event of default by a clearing member it will be suspended from trading. The clearing house will open a separate trust account with a bank into which will be paid all margin due and payable and any other moneys or securities held by the clearing house in favor of, on behalf of or for the account of the clearing member. The clearing house will manage the trust account and all the affairs of the clearing member arising from its JSE membership and assume control of all assets held or administered by the clearing member on behalf of or for the account or benefit of any member or client. The clearing house will close out all the proprietary positions of the clearing member at the

best price it can obtain and transfer all positions of clients and trading members cleared through the clearing member to another clearing member. Within a period decided by the JSE, each trading member must conclude a clearing agreement with another clearing member. The clients of the clearing member must enter into client agreements with other members and trade with the clearing house and such other members to transfer their positions to them, or trade with the clearing house to close out their positions.

After all liabilities of the defaulting clearing member have been settled, the amounts paid by any surety will be refunded from any balance remaining in the trust account and any further balance remaining will be paid to the defaulting clearing member. If there are insufficient funds to cover such liabilities, the clearing house will call on all clearing members for an equitable contribution on a voluntary basis to make good any shortfall. If such contributions are insufficient, the funds of the Fidelity Fund will be applied.

The same principles apply under the IRC Rules.

The Insolvency Act states that the liquidator is bound by the rules of the relevant exchange regarding the closing down of open positions. The relevant rules of the exchange regarding unsettled client trades at the time of default provide for the exchange to settle all trades with clients provided they can meet their settlement obligations.

#### *Information sharing*

Section 73(2) of the FMA provides that a market infrastructure may disclose information relating to or arising from its functions to any market infrastructure or supervisory authority, whether domestic or foreign, if such disclosure will further one or more of the objectives of the FMA.

#### **Short selling**

##### *Reporting and monitoring*

According to Section 10.20 of the JSE Equities Rules, a member must ensure settlement of all transactions in equity securities affected by it through the central order book of the JSE equities trading system. It must also ensure settlement of all off book trades in equity securities it entered into as agent on behalf of a client or as principal with a client.

Naked short selling is not permitted under the JSE Equities Rules. A member may only enter a sell order or report a trade to the JSE equities trading system, if it has taken reasonable steps to satisfy itself that:<sup>52</sup>

- The equity securities to be sold are held in uncertificated form by the member's

<sup>52</sup> The client itself is also prohibited from placing a sell order, if it does not comply with these conditions.

	<p>CSD participant in the case of a controlled client or proprietary transaction, or by the client's CSD participant in the case of a non-controlled client transaction;</p> <ul style="list-style-type: none"> <li>• A controlled client has evidenced to a member that it owns the equity securities to be sold in uncertificated form and that such securities will be available for settlement on settlement date;</li> <li>• Another transaction has been concluded which provides for an equivalent amount of equity securities being available for settlement on the settlement date;</li> <li>• A satisfactory borrowing arrangement is in place which provides for an equivalent amount of equity securities being available for settlement on the settlement date; or</li> <li>• A corporate action provides for an equivalent amount of equity securities being available for settlement on the settlement date.</li> </ul> <p>Section 10.40.2 of the JSE Equities Rules provides that the Settlement Authority may:</p> <ul style="list-style-type: none"> <li>• Monitor the settlement obligations of members and their clients;</li> <li>• Ensure that the settlement obligations of members are met on the settlement date;</li> <li>• Monitor uncommitted settlements and take appropriate action in respect of such settlements;</li> <li>• Take action when the settlement of a transaction in equity securities is unlikely to take place on settlement date;</li> <li>• Buy and sell equity securities through the JSE equities trading system to meet any obligations arising from the management of the settlement process and the risks associated with such process;</li> <li>• Borrow as agent on behalf of a member as undisclosed principal equity securities from third parties to facilitate the management of the settlement process and the risks associated with such process;</li> <li>• Levy fees on members for the loan of equity securities to members in order to facilitate the settlement process;</li> <li>• Impose penalties on members for any action or omission by a member which is potentially disruptive and/or has the effect of disrupting the settlement process and the functions of the Settlement Authority;</li> <li>• Instruct a member or a client (via the member) to roll the settlement of a purchase or sale transaction;</li> <li>• Instruct a member or a client (via the member) to close a purchase or sale transaction; and</li> </ul>
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	<ul style="list-style-type: none"> <li>• Manage the settlement of off book trades where ring fencing has occurred.</li> </ul> <p>There is no reporting requirement to the JSE, the FSB or the market on short selling, neither do they undertake any particular monitoring of short selling activities. There are no specific short selling exceptions in place.</p>
Assessment	Broadly Implemented
Comments	<p>The JSE has developed systems to monitor and manage the risk of open positions in its equities and derivatives trading systems that include margin requirements. Default procedures are in place and disclosed to the market participants through the JSE Rules.</p> <p>Naked short selling is prohibited and covered short selling is defined in a relatively narrow manner, taking into account the need to control the settlement risk arising from short selling. However, there is no general reporting requirement in place. As stated in the IOSCO Assessment Methodology, there should be a reporting regime in place that provides, at a minimum, timely short selling information to the market authorities (i.e. the JSE and/or the FSB). Preferably disclosure of short selling information should be extended to the market as a whole. In addition, the IOSCO Assessment Methodology requires the market authorities to undertake surveillance of short selling activities.</p>
<b>Principles Relating to Clearing and Settlement</b>	
<b>Principle 38.</b>	Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	
Assessment	Not assessed.
Comments	