THE BANKING ASSOCIATION SOUTH AFRICA
Tel +27 11 645 6700
Fax +27 11 645 6800
P O Box 61674
Marshalltown 2107
www.banking.org.za
3rd Floor Building D
Sunnyside Office Park
32 Princess of Wales Terrace
Parktown 2193

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Hon. Yunus Carrim, MP
Chairperson
Select Committee on Finance
National Council of Provinces

Attention: Mr. Nkululeko Mangweni
Committee Secretary
NCOP Select Committee on Finance
National Council of Provinces

via email: nmangweni@parliament.gov.za

Doc Ref: Gary#305054v1
Your ref: B15B-2020
Direct ☎: +27 11 645 6708
E-✉: GaryH@banking.org.za

Dear Hon. Chairperson Carrim

FINANCIAL SECTOR LAWS AMENDMENT BILL [B15B-2020]

We thank the NCOP Select Committee on Finance for calling for comment on the Financial Sector Laws Amendment Bill (FSLAB). We understand that this is based on the passing of the Bill by the National Assembly and referral to the NCOP for concurrence. We also understand that the Select Committee on Finance had received a briefing from National Treasury on the Bill in June 2021. While reviewing the FSLAB we have unfortunately picked up what we consider to be a drafting oversight that was not immediately obvious. We do not believe that this issue means that the legislator differs from a substantive point of view and instead consider the issue to be relatively easily rectifiable .

The issue at hand concerns the proposed introduction of sections 166S(7) and (9) of the Financial Sector Regulation Act 2017 ("FSRA") which grant the Reserve Bank resolution powers to reduce the amount payable under an agreement (section 166S(7)(a)) or cancel an agreement (section 166S(7)(b)).

Section 166S(9) carve outs from the Reserve Bank's powers for the following types of agreements:
(a) an unsettled exchange traded transaction;
(b) a derivative instrument (as defined in the Financial Markets Act 2012 ("FMA");
(c) a deposit where the deposit holder is the Corporation for Public Deposits;
(d) an unsecured transaction between two or more settlement system participants as defined in the National Payment System Act.

Unfortunately, we are of the opinion that the above carve outs do not cover Securities Financing and repurchase agreements ("Prime Finance Agreements") as such agreements clearly do not fall within carve outs (a), (c) and (d). Further, it is strongly arguable that such agreements do not fall within the definition of a "derivative instrument" in the FMA (carve out (b)).

For ease of reference, we set out below the definition of a "***derivative instrument***":
"derivative instrument" means any -
(a) financial instrument; or

(b) contract,
that creates rights and obligations and whose value depends on or is derived from the value of one or more underlying asset, rate, or index, on a measure of economic value or on a default event;"

In our opinion, the rights and obligations arising under Prime Finance Agreements do not depend on the value of underlying assets, rates, indices or measures of economic value or a default event. Prime Finance Agreements document shadow banking products which are treated differently by regulators from derivatives. Based on our interpretation of the definition of a "derivative instrument", the result is that there is therefore effectively no carve out for Prime Finance Agreements if proposed section 166S(9) is not amended.

Section 68(6B) of the current Banks Act 1990 specifically provides that section 35B of the Insolvency Act, 1936 ("**Insolvency Act**") applies to the curator of a bank under curatorship. Section 35B(2) of the Insolvency Act provides for the netting of a "master agreement" which is broadly defined in section 35B(2) as "an agreement in accordance with standard terms published by the International Swaps and Derivatives Association, the International Securities Lenders Association, the Bond Market Association or the International Securities Market Association, or any similar agreement, which provides that, upon the sequestration of one of the parties all unperformed obligations of the parties in terms of the agreement" can be netted.

Section 35B of the Insolvency Act is a key section which facilitates derivatives and prime finance type trading activities amongst local banks and between local banks and foreign counterparties. Banks derive capital relief for collateralised transactions documented under a master agreement which enable the parties to effect post-insolvency netting.

In the circumstances, we would recommend that section 166S(9) should read as follows:

"166S(9) Subsection (7) does not apply to the following:

(a) An unsettled exchange traded transaction, including a transaction on a licenced exchange;
(b) a derivative instrument a "master agreement" as defined in section 35B of the Insolvency Act1 of the Financial Markets Act;
(c) a deposit where the deposit holder is the Corporation for Public Deposits established by section 2 of the Corporation for Public Deposits Act, 1984 (Act No. 46 of 1984);
(d) an unsecured transaction between two or more settlement system participants as defined in section 1 of the National Payment System Act, made for the purposes of that Act."

We also wish to state that following on from our previous submission, BASA has been in further discussions with National Treasury regarding the impact of changes to the Insolvency Act as a part of the South African Resolution Regime as per the FSLAB. We have provided National Treasury with recommendations and National Treasury are considering these recommendations that would not necessitate any changes to the FSLAB, as we understand.

We remain confident that National Treasury will resolve this matter and the matter raised above, prior to the promulgation of the FSLAB into law. For information purposes, I have included our correspondence with National Treasury as **Annexure A**.

Always assuring you of our best attention.

Gary Haylett
Prudential Division