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The exemption provisions contained in section 49A, read with section 6(3)(m) of the Financial Markets Act

1. The JSE raised its concerns in respect of the exemption provisions as set out in section 49B of the Financial Markets Act **("FMA"**) incorporated in the October 2015 version of the Financial Sector Regulation Bill **("FSRB"**) and these provisions were subsequently omitted from the draft July 2016 version.

2. The concern of the JSE, however, remains given that these exemption provisions are now included in the consequential amendments to section 49A of the FMA:

   "(1) An external central counterparty must be licensed under this section to exercise functions or duties, or provide services as prescribed in terms of section 5(1)(c) and (2), unless it is exempt from the requirement to be licensed."

3. It would seem, by the inclusion of these provisions, that an external central counterparty that wishes to be exempted from the requirement to be licenced in South Africa must apply for such an exemption in terms of section 49A, read with section 6(3)(m) of the FMA.

4. Section 6(3)(m) sets out the principles that must be applied when exempting a person from the ambit of the FMA and states that:

"In performing those functions the registrar may exempt any person or category of persons from the provisions of a section of this Act if the registrar is satisfied that-

(i) the application of said section will cause the applicant or clients of the applicant financial or other hardship or prejudice; and

(ii) the granting of the exemption will not-

(aa) conflict with the public interest; or

(bb) frustrate the achievement of the objects of this Act."

5. An exemption from the provisions of the FMA would, at a minimum, need to comply with these principles and in particular, the exemption cannot (i) conflict with the public interest; or (ii) frustrate the achievement of the objects of the FMA.

6. The objects of the FMA, as set out in section 2, are clear; namely to, ensure that the South African markets are fair, efficient and transparent, promote the protection of regulated persons, clients and investors, reduce systemic risk and promote the international and domestic competitiveness of the South African financial markets and of securities services in South Africa.

7. The licensing requirements applicable to all market infrastructures (**"MIs"**) (including external CCPs) that wish to conduct business in South Africa are integral to the robust regulatory framework of the South African financial markets as set out in the FMA and as such, it is the view of the JSE that an exemption from the licencing requirements as contained in the proposed consequential amendments would be contrary to the underlying purpose of these very same licencing requirements and at odds with the objects of both the FMA and FSRB.

8. It is acknowledged that the only MIs that may apply for exemption from the peremptory licensing requirements that are applicable to all other MIs are external central counterparties, but as a matter of principle, an exemption that is afforded an external MI would introduce unfairness into the South African financial market, by permitting such exempted MI to provide the same services as a domestic licenced MI, but with the ability to do so without a licence.

9. Were an exemption from the licencing requirements under this proposed consequential amendment granted to an external CCP, such could undermine the financial stability of, and introduce systemic risk

into the South African market. It has been recognised, both in South Africa and abroad, that in order to ensure financial stability, the management of risk should be done on a system-wide basis and by way of a macro-prudential regulatory approach that reduces the risk of regulatory arbitrage as a result of it being of universal application.

10. If external MIs were to be exempted from the oversight of the South African authorities, their regulation would effectively be outsourced to a foreign regulatory body in the jurisdiction in which the MI is licenced. This denudes the oversight and/or regulatory role that the South African authorities may wish to fulfil in respect of these entities.

11. In the event of an economic crisis, such as the one experienced in 2008, the consequences arising from a deficiency in regulatory oversight could be severe. South Africa was largely insulated from the recent financial crises as a result of the direct supervision of the local regulatory authorities and the robust risk management policies of the licensed South African MIs, including the JSE, JSE Clear and STRATE.

12. The JSE recognises that the cross border nature of financial markets requires an appropriate supervisory and co-operative regulatory framework if an external MI wishes to perform the functions of an external CCP within South Africa, but the removal of the requirement for such an external CCP to be licenced in South Africa does not of itself achieve the objective of cooperation. If an external MI were to fulfil the same duties and functions as a licensed domestic MI, it is the view of the JSE that the concept of fairness in respect of access to the market and the stability of the South African financial system would require that the South African authorities regulate the business of the external entity themselves and not place reliance on a foreign authority to perform this role, especially as the business that the foreign MI would be carrying out would be in South Africa. Regulatory oversight of all MIs that operate in South Africa is fundamental to ensuring the stability of the South African financial system.

13. An appropriate set of criteria for the assessment of external central counterparties should form part of the regulatory framework applied in South Africa, which would enable an external central counterparty to be qualified, for example, by those South African banks that face external central counterparties in foreign jurisdictions. The benefit of such a situation is that it would be possible for these South African banks to obtain capital relief, in terms of the Basel Capital and Risk requirements, as provided for in the Regulations to the Banks Act. In this way, the recognition of equivalent foreign jurisdictions and the

recognition of qualified central counterparties could play an important role in determining whether such entities meet the peremptory requirements of licensing in the event that these external central counterparties wish to conduct business in South Africa. The recognition of a qualified external MI and its jurisdiction should, however, not be considered sufficient reason to provide an external MI with an exemption from the need to be licenced to fulfil the functions and duties of an MI in South Africa. The concepts of "recognition" and being "qualified" on the one hand and being "licensed" on the other are separate and distinct from one another, each with their own purpose and requirements and without a causal link between them.

14. It is for these reasons that other statutes that deal with the regulation of systemically important financial institutions, such as the Banks Act and the Long and Short Term Insurance Acts do not permit the exemption of a foreign entity from the peremptory requirement of being licensed or registered, as the case may be, if it intends to conduct business of the same nature in South Africa. This should also be the position with external central counterparties that wish to conduct a business for which a licence is ordinarily required in South Africa.

15. The public has an interest in the effective regulation of the financial markets, which includes ensuring a level playing field to enable competition and the safeguarding of financial stability. The effect of unstable markets would be the introduction of systemic risk into the South African economy and markets, which would be financially prejudicial to members of the public and while compliance with international practice is an important consideration when determining whether a particular proposed law is in line with the public interest or not, the ultimate test should always be whether the proposed law could adversely affect the interests of the South African public.

16. In its response to the JSE's previous comments, National Treasury were of the view that the exemption of external central counterparties as proposed, was in accordance with international practice, but the JSE is of the opinion that the granting of an exemption in the manner proposed would be contrary to the public interest and at odds with the objects of the FMA and as such, the adoption of international practice, while sound in principle, will not remedy a situation in which such international practice is in conflict with the provisions of the FMA.

17. It is further the view of the JSE that no evidence has been advanced that addresses the JSE's concern that the wholesale exemption of an external MI would have the likelihood of introducing systemic risk and the reduction of competition in the South African market. While Canada and Australia are cited as countries that follow the exemption approach, the majority of international jurisdictions do not allow for the type of exemption contemplated in the proposed consequential amendments to the FMAs.

18. The research conducted by the JSE into the manner in which exemptions are handled in Australia indicates that exemptions in the Australian framework are not granted in an unqualified manner. The Australian regulatory structure narrowly defines the circumstances in which an exemption may be granted and the parties that are to provide advice and recommendations in this regard. For instance, the Australian approach requires that the circumstances in which the exemption is sought are to be exceptional and an exemption will not be granted if such could undermine the Australian licensing regime, even if it is shown that the external clearing and settlement facility is subject to sufficient regulation in the foreign country where its principal place of business is located.

19. Given the systemically important role of external CCPs, both in local and foreign jurisdictions, the failure by an external CCP would have disastrous effects on the South African financial markets and larger economy. It is therefore essential that South African regulators are able to exercise a suitable degree of control over external MIs, especially CCPs that conduct business in South Africa. This control can only be achieved through the effective regulation and supervision by the South African regulatory authorities of all MIs that conduct business in South Africa. A critical aspect of an effective regulatory regime is the requirement that all MIs have to be licensed and that the local regulatory authorities have effective oversight of these entities' activities in South Africa.

20. A licence condition of a local MI is that it fulfil certain functions and duties prescribed under the FMA and if it fails to do so, the Registrar may directly assume responsibility for one or more of these functions and duties as is necessary. In the event that an external central counterparty were exempted from having to obtain a licence, there would be no equivalent oversight role for the Authority were the exempted external MI to fail to perform their functions and duties and the Authority would not have the power to assume responsibility for the fulfilment of these important duties and functions.

21. It is the view of the JSE that were an exemption from the licensing provisions of the FMA to be granted to an FMI in the manner as suggested in section 6(3)(m)(iii), the inconsistency of such exemption with the licensing provisions of the FMA, as well as it being contrary to two of the primary objects of the FMA, would render the exemption unlawful and subject to challenge.