FSCA

Financial Sector
Conduct Authority

NOTICE REGARDING THE PUBLICATION OF DRAFT CONDUCT STANDARD [-] OF 2020 (RF)

CONDITIONS FOR SECURITIES LENDING FOR PENSION FUNDS

FINANCIAL SECTOR REGULATION ACT, 2017

PENSION FUNDS ACT, 1956

The Financial Sector Conduct Authority (Authority) hereby, in accordance with section 98(1)(a)(iv) of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017), invites submissions on draft Conduct Standard [-] of 2020 (RF) – Conditions for securities lending made in terms of section 106(1) of Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) and Regulation 28(6) of the Regulations made in terms of the Pension Funds Act, 1956 (No. 24 of 1956), as per the Schedule below.

The draft Conduct Standard, together with a statement supporting the draft Conduct Standard is available on the Authority's website at https://www.fsca.co.za.

Submission on the draft Conduct Standard must, using the submission template available on the Authority's website, be submitted in writing on or before **30 November 2020** to the Authority at **FSCA.RFDStandards@fsca.co.za**.

DUBE TSHIDI
For the FINANCIAL SECTOR CONDUCT AUTHORITY

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1. Definitions

In this Schedule, **"the Act"** means the Pension Funds Act, 1956 (Act No. 24 of 1956) and **"Regulations"** means the Regulations in terms of section 36 of the Act as published in GNR.98 of January 1962, and any word or expression to which a meaning has been assigned in the Act or the Regulations has that meaning and, unless the context otherwise indicates, –

"agent" means the person contemplated in paragraph 6;

"authorised financial services provider" means an authorised financial services provider as defined in section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002);

"authorised user" means an authorised user as defined in section 1 of the Financial Markets Act;

"central counterparty" means a licensed central counterparty as defined in the Financial Markets Act;

"clearing house" means a licensed clearing house as defined in section 1 of the Financial Markets Act;

"counterparty" means the borrower in a securities lending transaction;

"exchange" means a licensed exchange as defined in section 1 of the Financial Markets Act;

"Financial Markets Act" means the Financial Markets Act, 2012 (Act No. 19 of 2012);

"foreign insurer" means a person that is authorised and supervised by a regulator to perform business similar to life insurance business as defined in the Insurance Act in a jurisdiction determined to be equivalent in terms of section 65 of the Insurance Act;

"fund" means a pension fund organisation and "pension fund" or "registered fund" has the same meaning;

"Insurance Act" means the Insurance Act, 2017 (Act No. 18 of 2017);

"insurer" means an insurer licensed or deemed to be licensed to conduct life insurance business in terms of the Insurance Act;

"securities lending agreement" means a Global Master Securities Lending Agreement as published by the International Securities Markets Association from time to time or any other form of written agreement substantially similar thereof;

"nominee" means a nominee approved under section 5(3)(a)(iv) of the Act;

"securities lending transaction" means a "lending arrangement" as defined in the Securities Transfer Tax Act, 2007 (Act No. 25 of 2007), and for purposes of this Conduct Standard, a 'listed security' referred to in paragraph (a) of that definition also includes-

(a) listed debt instruments;
(b) money market instruments issued by a registered South African bank; and
(c) listed assets which reference a listed underlying asset or assets; and

"service provider" means a person who provides services to a fund in connection with securities lending transactions entered into by the fund, other than acting as the fund's agent.

2. Application

This Conduct Standard applies to a fund that enters into a securities lending transaction.

3. Contractual requirements

(1) A fund must undertake a securities lending transaction in terms of a securities lending agreement which must set out the rights and obligations of all the parties to the agreement.

(2) A securities lending agreement referred to in subparagraph (1) must –
- *(a)* identify the fund and the counterparty;
- *(b)* provide for the description of the securities that will be the subject of any securities lending transaction;
- *(c)* describe the type of collateral and the required margin of collateral that will be provided and state whether the collateral will be pledged or given by way of outright transfer and held by the fund or by a nominee on behalf of the fund;
- *(d)* state that the fund will not remain entitled to the benefits, such as corporate actions, dividends or other income associated with the lent securities;
- *(e)* provide for payments or settlements to be made by the counterparty to the fund in lieu of any corporate action entitlements, dividends or other income accrued or paid in respect of the securities that are the subject of the securities lending transaction; and
- *(f)* state that, in the case of a pledge, where the counterparty defaults or becomes insolvent, the fund will be entitled to the immediate transfer of the ownership and other rights, including voting rights, attached to the collateral.

(3) A securities lending agreement referred to in subparagraph (1) must set out, where applicable, the relevant conditions, parameters and processes to be adopted –
- *(a)* where the aggregate value of the collateral exceeds or falls below the value of the securities lent;
- *(b)* where the aggregate value of the collateral exceeds or falls below the agreed upon value of the collateral in relation to the value of the securities lent; and
- *(c)* in respect of the fees or charges payable by the counterparty or agent to the fund.

4. Principles

(1) A fund may only engage in a securities lending transaction as a lender if the securities lending transaction complies with the investment policy statement of the fund, the liquidity requirements of the fund and the principles set out in Regulation 28(2).

(2) Any securities that are subject to a securities lending transaction referred to in subparagraph (1) remain assets of the fund.

(3) Where a fund engages in a securities lending transaction, the securities lending transaction must be –
- *(a)* undertaken in a prudent manner;
- *(b)* in accordance with the lending policies and procedures that are approved by the fund; and

(c) with the purpose of providing additional income or fees to the benefit of the fund.

(4) A fund must ensure that controls and procedures relating to securities lending transactions are comprehensive and sound.

5. Service providers

(1) A fund may only delegate the administration of a securities lending transaction as provided for in section 7D(2) of the Act, including collateral management, to an authorised financial services provider.

(2) Where a fund delegates the administration of a securities lending transaction as contemplated in subparagraph (1), it must ensure that–

(a) the authorised financial services provider has the necessary experience and expertise to perform the required duties in a competent and professional manner; and

(b) the administrative and reporting arrangements and obligations of the authorised financial services provider are clearly set out and agreed to in writing.

6. Agents

(1) A fund may appoint an agent to enter into a securities lending transaction on its behalf.

(2) The agent referred to in subparagraph (1) may only be –

(a) an authorised user;

(b) a registered South African bank or a foreign bank; or

(c) an authorised financial services provider.

7. Counterparties

(1) A fund must ensure that when it engages in a securities lending transaction it –

(a) transacts with reputable and credit worthy counterparties as set out in subparagraph (2); and

(b) performs, or procures the performance of a due diligence of a counterparty taking into account at least the counterparty credit risk and, where available, credit rating issued by a registered credit rating agency or external credit rating agency prior to entering into a securities lending transaction.

(2) A fund, or agent acting on behalf of the fund, may only enter into a securities lending transaction with the following counterparties-

(a) an authorised user;

(b) a central counterparty;

(c) a clearing house;

(d) an exchange;

(e) an insurer or a foreign insurer;

(f) a registered South African bank or a foreign bank; or

(g) any other person who complies with the requirements as set out in this Schedule, provided that the obligations of that person in respect of the securities lending transactions are guaranteed by one of the entities referred to in items *(c)* or *(d) and* secured by the provision of collateral.

8 Annual review and continuous monitoring

(1) A fund must, at least annually, review and approve its securities lending policy in respect of –

(a) the types of securities that may be subject to securities lending transactions;

(b) the overall and individual securities lending limits of securities lending transactions related thereto;

(c) the general credit worthiness criteria used in establishing its list of approved counterparties;

(d) the person responsible for the monitoring of securities lending transactions;

(e) the quantity and quality of the collateral held against the lent securities and how collateral must be held;

(f) the method and person responsible for the collection of revenue from the securities lending transactions; and

(g) whether securities lending is beneficial for the fund, taking into account the relevant risks associated therewith.

(2) A fund must continuously monitor and verify at appropriate intervals that –

(a) the fund has followed the internal procedures and standards established in determining the quality of a counterparty;

(b) the securities accepted as collateral are consistent with the approved securities lending policies of the fund;

(c) the securities lent out do not exceed the maximum allowable limit as determined in paragraph 10; and

(d) the collateral exists, the value placed on the collateral is reasonable and that the collateral held exceeds or is equal to the minimum collateral required.

9. Right of recall

(1) Subject to subparagraph (2), any securities lent by a fund must be subject to an unqualified right of recall by the fund and the terms of recall must provide that a fund may give notice for such securities to be returned, subject to the standard settlement cycle on the relevant exchange.

(2) A fund may agree in writing with the counterparty that a specified securities lending transaction will not be recalled prior to an agreed date unless the fund is required to do so as a result of liquidity constraints or investment decisions.

10. Securities lending transaction limits

(1) The aggregate value of all equity, money market and debt instruments that are the subject of a securities lending transaction may not at any time throughout the reporting period exceed the following:

Description	Maximum % of fair value of portfolio
Listed equities – top 25% of companies (by market cap) listed on an exchange as indicated in the Johannesburg Stock Exchange Limited Quarterly Review	75%
Other listed equities, including listed assets which reference a listed underlying asset or assets	50%
Debt – Government bonds	75%
Other listed debt instruments	50%

Money market instruments issued by a registered South African bank, including an Islamic liquidity management financial instrument	75%

(2) For purposes of calculating the limits referred to in subparagraph (1), South African and foreign holdings must be calculated separately and not be aggregated in determining the limits.

(3) Where a fund has entered into a securities lending agreement and the listed equity delists during the reporting period, the fund must apply to the Authority for exemption from the inclusion of such delisted equities in the calculation of the limits in respect of the relevant transaction.

11. Collateral

(1) A fund must ensure that -
- *(a)* adequate collateral is held at all times to protect the fund against the risks associated with securities lending;
- *(b)* the margin of collateral in excess of the fair value of the securities lent is appropriate at all times and provides adequate protection against volatility and liquidity concerns that may arise for securities lent and for securities held as collateral.

(2) Subject to subparagraph (5), collateral for the securities lent by a fund must at all times comprise–
- *(a)* cash or bank issued money market instruments equal to at least 105% of the fair value of the total securities lent; or
- *(b)* debt instruments of which the fair value is equal to at least 110% of the fair value of the total securities lent; or
- *(c)* equities of which the fair value is equal to at least 115% of the fair value of the total securities lent; or
- *(d)* a combination of assets as per items *(a)*, *(b)* and *(c)*, on condition that the limits set will be applied in the same proportion as the total collateral held.

(3) Where the counterparty is a registered South African bank, a fund and the counterparty may agree that the counterparty will not be obliged to provide collateral.

(4) Where a counterparty does not provide collateral as contemplated in subparagraph (3), 105% of the fair value of the securities lent will be deemed to constitute part of the counterparty limit set out in Regulation 28(3)(h) and items 1.1 and 2.1 of Table 1 under the Regulations.

(5) For purposes of this Schedule, "outright transfer" refers to the method of mitigating credit exposure which the fund would have against a counterparty to which it has lent its securities by requiring the counterparty to transfer of ownership to the fund of a collateral asset that is of an equal or of a greater value than the securities lent, provided that-
- *(a)* the fund and the counterparty agreed that in the event of a default, the obligation of the fund to return the collateral asset and the obligation of the counterparty to return the securities lent, will terminate;
- *(b)* the value of the securities lent by the fund to the counterparty and the value of the collateral assets transferred by the counterparty to the fund will be established; and
- *(c)* the values referred in item *(b)* will be netted against each other and the net amount, be it an amount payable by the fund to the counterparty or by the

counterparty to the fund, as the case may be, will be settled in terms of a lending agreement.

(6) The collateral of a fund as referred to in subparagraph (1) may be effected through-
(a) a pledge or cession in security to the fund of the cash, money market instrument, debt instrument or equity ("collateral asset"); or
(b) an outright transfer of the collateral asset to the fund.

(7) If a fund elects the outright transfer method referred to in subparagraph (6)(b)-
(a) where the collateral is held in cash, it must be held in the name of the fund;
(b) where the collateral consists of money market instruments, debt instruments or equities, the money market instruments, debt instruments or equities must be held in the name of the fund, or by a nominee on behalf of the fund and must be clearly identified as collateral.

12. Counterparty limits

For purposes of the 25% counterparty limit as set in Regulation 28(3)(h) and items 1.1 and 2.1 of Table 1 of the Regulations, the counterparty exposure arising as a result of a fund entering into a securities lending agreement with a registered South African bank will not be taken into account in respect of the 25% limit.

13. Short title, commencement and repeal

(1) This Conduct Standard is called the Conditions for Securities Lending for Pension Funds, 2020.

(2) This Conduct Standard comes into operation on date of publication thereof.

(3) Board Notices No. 2 of 2012 and No. 4 of 2012 are hereby repealed.

14. Transitional arrangements

A fund, including all securities lending transactions entered into by the fund before the coming into operation of this Conduct Standard, must comply with this Conduct Standard within six months of coming into operation of this Conduct Standard.