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Ms Kershia Singh
National Treasury

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Dear Ms Singh

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DRAFT FINANCIAL SECTOR LEVIES BILL

The JSE welcomes the opportunity to comment on the draft Financial Sector Levies Bill ("the Bill") and the Supplement to the Impact Study of the Twin Peaks Reforms ("the Supplement") published by National Treasury at the request of the Standing Committee on Finance. Our initial comments were discussed during a teleconference on 17 January 2017 with National Treasury, representatives of the SARB and the Financial Services Board and some of these comments have been included in this submission.

1. General comments

- 1.1 The JSE is supportive of and recognises the benefits of the new regulatory system and we are of the opinion that the Twin Peaks supervisory model will meet the policy objectives outlined in the Financial Sector Regulation Bill ("FSR Bill"). However, we firmly believe that these benefits should be balanced with the cost of the reforms which will inevitably raise the costs for financial consumers.
- 1.2 Our concern, specifically, is in respect of the cumulative effect of the regulatory levies and fees which will be passed on by supervised entities to participants, investors and financial consumers. A significant increase in the cost of regulatory oversight which will translate into an increase in the cost of trading could lead to unintended consequences such as a decline in liquidity in the South African capital markets and the diminished attractiveness of South Africa as an investment destination.
- 1.3 The JSE, like other global exchanges, is under extreme pressure to reduce execution, clearing and settlement costs and a significant increase in regulatory fees will necessitate that the JSE passes on this cost to market participants, potentially rendering the exchange uncompetitive as a trading venue and a listing venue, particularly in respect of the dual listed securities.
- 1.4 In addition to our concerns regarding the potential impact on investors and the South African financial markets of a significant increase in the cost of supervision under a new regulatory structure recovered through regulatory levies, we are also concerned about the manner in which the Bill proposes to apportion the cost of regulatory supervision amongst the various market infrastructures. The JSE is of the firm view that regulatory levies or fees payable by a market infrastructure should be calibrated to the intensity of regulation and supervision required and should be proportional to the nature, scale and complexity of regulatory risks present in that type of market infrastructure. We do not believe that a levy based on the value of securities traded with a low fixed fee component, as proposed, will achieve that objective.

Executive Directors: NF Newton-King (CEO), A Takoodeen (CFO)

Non-Executive Directors: N Nyembezi-Heita (Chairman), AD Botha, Dr M Jordaan, Dr SP Kana, DM Lawrence, Dr MA Matooane, AM Mazwai, NP Mnxasana, NG Payne

Alternate Directors: JH Burke, LV Parsons

Group Company Secretary: GA Brookes

2. Budget, fees and levy proposals

- 2.1 It is unclear whether the Supplement published with the Bill represents the budget required in terms of section 239(1) of the FSR Bill or whether the Supplement was published merely as an indicative guide as it provides no details in respect of the nature of the expenditure of each of the financial sector bodies. In addition, an estimate of expenditure giving rise to the special implementation levy has not been provided as required in terms of section 239(2).
- 2.2. Table 2 of the Supplement sets out an estimated annual levy for central counterparties of R10m and the Schedule to the Bill provides for a levy of R10m per central counterparty indicating that only one central counterparty is envisaged in the South African market. However, it is our understanding from the discussion with National Treasury that it is expected that multiple central counterparties will be licensed in South Africa which could result in a significant over collection of levies.

3. Market infrastructures

- 3.1 Section 1 of the Bill provides for the definitions of “central counterparty”, “external central counterparty”, “trade repository and “external trade repository”, however the Schedule refers only to a “central counterparty” and “trade repository”. It is not clear whether it is intended that the terms central counterparty and trade repository, as set out in the Schedule, include external central counterparty and external trade repository or whether levies or fees are not applicable to these types of market infrastructures.
- 3.2 Although “clearing house” is defined in section 1 of the Bill, no provision is made for this type of market infrastructure in the Schedule to the Bill. In terms of the Financial Markets Act, as amended, an entity may be licensed as an independent clearing house and not be licensed as a central counterparty. We recommend that the Schedule should include a levy payable by an independent clearing house that is not a licensed central counterparty or external central counterparty.
- 3.3 No provision is made in the Schedule for the levying of an exempted market infrastructure (e.g. central counterparty), even though the process to exempt such an entity from licensing and the ongoing monitoring obligations by the relevant Authority will require significant supervisory resources. We respectfully recommend that provision is made in the Schedule for a levy for exempted market infrastructures which reflects the intensity of the supervisory effort required.

4. Calculation of the exchange levies

- 4.1 We have not repeated the points raised in our discussion on the accuracy of the formulae provided for in the Schedule as it is our understanding that the percentages used in the calculation will be adjusted before the final version of the Bill and Schedule is passed. We have also not repeated our comments on the price point of the levies. However, we are of the view that there should be no material change to the supervisory effort of FSCA relative to the current supervisory effort of the FSB in respect of the JSE and the levy payable by the JSE to the FSCA should therefore be approximately the quantum of the total of the two levies (Exchange levy and DMA levy) currently paid, adjusted for an inflationary increase.

- 4.2 The JSE appreciates the drivers of the model to calculate levies in respect of exchanges, particularly the need to encourage competitiveness in the market and to ensure that the levies do not serve as a barrier to entry for new exchanges. However, the methodology for the calculation of the levies for exchanges has some challenges.
- 4.3 The JSE is required to extensively consult within predefined notice periods for implementation with market participants on any changes to trade, clearing and settlement costs. The JSE currently imposes a levy on investors to recover its external regulatory costs and, as mentioned, we intend to continue this practice in future to recover the new regulatory levies imposed by the two authorities. The consultation and implementation period may be lengthy, particularly if the recovery of the costs by the JSE requires system changes. An example of one of the challenges that we will face is that the JSE does not currently have a mechanism to recover costs based on value traded in the derivatives markets.
- 4.4 Our view is that a model with a low floor and an ad valorem based on value traded may not be an appropriate model as -
 - a) It does not accurately reflect the intensity required to supervise an exchange. The intensity of supervision required is driven by the number of types listed products, the variety of asset classes, the nature of the traded market and the complexity of securities listed and traded.
 - b) In the absence of a cap on the levy, the cost is unpredictable for an exchange and its customers and poses a risk of over-recovery of expenditure by the financial sector bodies in periods of high volume.
 - c) The low floor (base amount) may not be sufficient to cover the supervisory effort associated with each market infrastructure, particularly in respect of a new entrant which may require intensive supervisory effort in a startup phase, and a possible event driven expense of a market abuse investigation.
 - d) An ad valorem levy applied to value traded in the bond market is not proportional to the supervisory effort required in this market due to the high denominations in which bonds are traded (and therefore the high value of trading in bonds relative to other asset classes) but the lower level of regulatory risks associated with bond trading relative to most other asset classes.
 - e) Similarly, derivatives are traded as a number of contracts rather than a value and it would be inappropriate to use the value of the underlying instruments or commodities as a proxy for the value of derivative trading. We note the SEC model levies an amount per contract on derivative instruments.

- 4.5 Our preference is for a flat fee per annum (which may include tiers for scale of market/product) which would enable the JSE to allocate and recover the costs fairly and appropriately. Failing the introduction of a flat fee model, we respectfully request that we are able to engage with the Authorities to develop and implement a model that is fair and reflects the supervisory intensity required. The high-level elements of a proposed alternate model are as follows:
- i. The base amount should be increased to provide for the minimum supervisory effort and, in the case of the FSCA levy, tiered to reflect the scale and maturity of the exchange to provide for the actual level of supervisory oversight and interventions required for each exchange, including, for example, the effort required in conducting market abuse investigations. Under and over recovery of the cost of investigations can be adjusted at regular intervals (e.g. quarterly);
 - ii. The model should provide for the differentiation of markets e.g. equities, bonds and derivatives and the ad valorem should be based on appropriate variables e.g. value of trade in the equities market with a cap based on value of trade, cost per contract in the derivatives market and cost per R1million nominal in the bond market.
 - iii. The exchanges must be required to provide forecast data on a quarterly basis to the Authorities to enable any adjustment to the model on a timely basis. .

We look forward to the revised version of the Bill and reiterate our willingness to engage on the development of a fair and representative model for calculating levies for exchanges.

Yours sincerely

Anne Clayton
Head: Public Policy