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INTRODUCTION

Banking has come a long way: from grain loans to digital banking and now cryptocurrency banks are on the horizon. For everyone from, in all probability, the Baby Boomer Generation to Generation Z, the changes have been dramatic.

Although it is unlikely that the traditional monetary systems and indeed banking systems will disappear any time soon, it is possible that in time international cryptocurrencies may provide a solution to the devaluation of currencies brought about by global crises – financial or otherwise. As without prejudice goes to print the rand/dollar value has depreciated from R3.55 in 1994 to its current R14.31 and from R6.44 to today’s R18.20 against the pound. This has seen a concomitant rise in inflation and interest rates and increased poverty.

Regrettably, however, the initial predictions of cryptocurrencies being hacker-proof were off the mark and it is going to remain a no-go area for the risk averse for some time. Globally, legislation and bank regulations remain a challenge so the future remains uncertain – as it always is.

Facebook has announced its plans for a cryptocurrency. The currency is to be called Libra and it will be managed by a group of companies that have equal say. Of the 100 companies Facebook hopes will be in the Libra Association, 30 have already signed up. On-board are some big names – Mastercard, Visa and PayPal, Uber Technologies, Spotify and Vodafone Group. And Naspers is in there too. This is a space to watch.

In South Africa there are new banks targeting different markets: Discovery Bank and Bank Zero, African Rainbow Capital’s digital bank TymeBank opened for business in November 2018. It aims to offer cheap transactional services, among others, to those who fall into LSM 5 to 7 and who are underserved (an estimated 37 million people) by traditional banks.

The Financial Matters Amendment Bill was adopted in March. This will enable state-owned entities to participate in the retail and commercial banking sector. It will allow the Postbank to get a licence. Currently the chances of one’s mail reaching its destination are dismal; perhaps the Post Office needs to get that right before attempting to compete with banks.\(^*\)

The South African Banking Risk Information Centre (SABRIC) released its inaugural digital banking crime statistics. It stated that in 2017, “13 438 incidents across banking apps, online banking and mobile banking cost the industry more than R250 000 000 in gross losses”. Of concern is that from January to August 2018, figures showed a 64% increase when compared to that period in 2017. When comparing January to August 2017 to the same period in 2018: mobile banking incidents increased more than 100% (gross losses were R23 953 631), online banking incidents increased 44% (gross losses of R89 368 722); banking app incidents increased by 20% (gross losses - R70 156 364). But it was the 104% increase in SIM swap incidents from January to August 2018 in comparison with that of 2017 (8 254 from 4 040) that should raise eyebrows, and increase vigilance.

There are many projects in the pipeline in Africa; they all need financing. It is essential that economic growth and investor confidence is restored to ensure successful borrowing. In South Africa, talk of compromising the independence of the South African Reserve Bank did little to increase the international finance community’s confidence in government or to encourage investors.

Unless one is in the banking sector, chances are that one knows very little about the role of the South African Reserve Bank. I asked Johann de Jager, General Counsel for the Reserve Bank, if he would write about nationalisation of the Bank. I am extremely appreciative that he took the time to write a most informative and particularly interesting article that will leave readers far more aware of the role it plays and of course that of government.

The wide variety of topics in this feature, including the impact of corruption, legislation and regulations, and Kenya’s new approach to combat the curse of money-laundering and terrorism financing make for fascinating reading. I am grateful to all those who have written to broaden our understanding of this area. •

Myrie Vanderstraeten

\(^*\) See Editor’s note
Governments and Central Banks

Governments throughout the world are ultimately responsible for monetary and fiscal policy within the economy of their respective jurisdictions. They need to guide the overall pace of economic activity by striving towards maintaining steady growth, high levels of employment and price stability. From the mid-seventeenth century onwards central banks were established by governments as important mechanisms for addressing the monetary demands of economies and the health of financial systems. It resulted in the typical non-commercial, non-profit maximising public interest nature of central banks, normally subject to various forms of government supervision or control.

Governments, which consist of decision-makers who are subject to political election cycles, are however prone to act in a more short-sighted manner when exercising monetary policy. The temptation for them lies in the fact that money creation has positive effects in the short term, on growth and employment, while the costs, in terms of higher inflation, are paid in the medium term or longer. Since most world currencies consist of paper (fiat) money without any underlying asset, governments are tempted to increase money supply in an attempt to grow their respective economies faster than capacity limits allow and to fund budget deficits, resulting in increased inflation. This creates an inflation bias, making it difficult to credibly guarantee actions which would validate low inflation over time.

Since high inflation gives rise to instability and is not conducive to growth in the economy and employment, measures need to be implemented to address conflicting priorities in policy-making and to anchor prices against inherent swells in inflationary pressures.

The South African Reserve Bank (SARB or BANK)

Structure and Objective

The SARB, an executive organ of state, currently functions in terms of the Constitution of the Republic of South Africa Act (108 of 1996), read with the South African Reserve Bank Act (90 of 1989) (SARB Act). The stated primary objective of the Bank is to protect the value of the currency, in the interest of balanced and sustainable economic growth in the Republic. In terms of the Financial Sector Regulation Act (9 of 2017) the Bank is also responsible for protecting and enhancing financial stability in the RSA. The primary objective of the SARB to maintain price stability and enhance financial stability form part of the greater whole economy of the RSA and has the same final objective as the other components of total macro-economic policy, namely, the accomplishment of the highest growth rate in the long term to the benefit of the general public.

Independence

The Constitution determines that the SARB, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but that there must be regular consultation between the Bank and the Minister of Finance. In a legal context, this provision in the Constitution may be regarded as a guarantee of independence of the highest statutory order in favour of the SARB. Accordingly, the SARB conducts monetary policy, free from interference, within an inflation-targeting framework in terms of which it endeavours to maintain the consumer-price inflation within a designated target range, set by government after consultation with the Bank. In the process, a flexible framework is maintained which takes cognisance of the impact of monetary policy on cyclical growth and employment for purposes of minimising the impact of decisions on those factors as far as possible.

Shareholding

The SARB is one of a few central banks in the world which maintains a legal structure that provides for private shareholding. The Bank has an authorised (and issued) share capital of two million rand, divided into two million ordinary shares of one rand each, which may be acquired, held and disposed of by the general public, subject to limitations set by the SARB Act. Unlike public companies with a profit
motive, the SARB needs to pursue its goal in the interest and to the benefit of the country as a whole and therefore in the interest of the general public in the country. This non-profit maximisation public interest role of the Bank necessitated a realignment of the rights, powers and status of its shareholders to specifically suit those of shareholders in a central bank. Considerations of public interest and fundamental principles of central banking and the law militate against a central bank being owned and controlled by its private shareholders or anyone else. Shareholders of the SARB constitute less important stakeholders whose interests must at all times yield to the interests of the general public and Government.

Powers and Limitations
The SARB Act and the regulations made in terms thereof regulate these matters. Individual shareholders are prevented from exercising undue influence over the Bank. No shareholder, together with his, her or its associates may hold more than 10 000 shares in the Bank. In confirmation of the non-profit goal of the Bank, shareholders receive a fixed dividend at a rate of ten cents per annum per share, provided that profits are realised. Voting is restricted to one vote for every 200 shares held, with a maximum of 50 votes per individual shareholder (together with his, her or its associates), which may be exercised at meetings of shareholders of the Bank.

Shareholders, together with members of the general public and serving directors on the Board, are able to nominate persons for consideration and possible designation by a Panel (consisting of the Governor, as chairperson, with a deliberative vote, a retired judge and one other person nominated by the Minister, as well as three persons nominated by NEDLAC – “Panel”) as suitable candidates for potential appointment into existing vacancies on the Board. At the annual general meeting of shareholders of the Bank (OGM), held once a year, shareholders are entitled (provided that relevant vacancies exist) to elect a maximum of seven non-executive directors to the Board from a list of potential candidates confirmed by the Panel. Furthermore, the business conducted by shareholders at the OGM consists of the presentation and discussion of the annual and audit report, the appointment of auditors and the approval of their remuneration, special business (limited to issues related to the aforesaid) of which proper notice was given and any further business arising from such items.

Supervision
The SARB is supervised by a board consisting of fifteen directors, of whom eight (including the Governor and three Deputy Governors) are appointed by the President of the RSA and seven non-executive directors by the private shareholders in the Bank. The management of the business of the SARB vests with the Governors. The Board and the shareholders have no authority over, and play no role in, the crucial function of monetary policy, which is conducted independently in committee by the monetary policy committee (MPC) of the Bank, consisting of the Governors and designated senior officials of the SARB. All directors are required to exercise their duties on behalf of the SARB.

Nationalisation
Government in recent times expressed its intention to nationalise the SARB by taking over ownership and control of the Bank from its shareholders. However, the Bank’s shareholders merely constitute minor stakeholders of the SARB who exercise no control over the Bank. At most, a form of indirect governance responsibility in respect of the SARB is shared between government, the shareholders and the general public in the appointment of directors, in terms of which government plays the dominant role. Any endeavour by government to nationalise the SARB by taking over, or terminating the shareholding structure of the Bank will not factually or legally result in ownership of the SARB being acquired by government or anyone else. It will, at most, result in the termination of an independent governance measure that enhances the effectiveness of the Bank’s institutional structure.

The SARB, an executive organ of state, has since its early establishment as a central bank functioned as a public interest, non-profit maximising, non-competitive statutory institution, incapable of being legally owned. The public interest and economic development in the RSA has, right from its inception, always been at the centre of the existence of the SARB. Any such proposed nationalisation will also not affect the way in which the Bank fulfils its primary objective. It will still function independently, without fear or favour, in its endeavours to protect the value of the currency in the RSA, in the interest of balanced and sustainable economic growth, for the benefit of the general public in the country. If the independence of the Bank was to be affected, it would require an amendment to the Constitution. The President, however, indicated that government did not seek to interfere with the Bank’s independence since the Constitution was clear on how independent the SARB should be.

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WILL THE CHICKENS OF CORRUPTION COME HOME TO ROOST?

WILLEM JANSE VAN RENSBURG

In the past two decades countries across the globe have committed to combatting money laundering (ML) and terrorist financing (TF). South Africa has been a global player with a robust economy and one of the most efficient and modern financial sectors in the world, committed to its role as a country focused on protecting the global financial system against money laundering and terrorist financing.

The Financial Action Task Force (FATF), the inter-governmental regulating body, is expected to complete its comprehensive assessment of South Africa’s compliance with international Anti-Money Laundering (AML) standards this year. Such an assessment is done by means of a mutual evaluation conducted by representatives from the FATF; the International Monetary Fund (IMF) and the Eastern & Southern Africa Anti-Money Laundering Group (ESAAMLG). The Mutual Evaluation Report (MER) will provide an in-depth descriptive analysis of South Africa’s system for preventing criminal abuse of the financial system. This mutual evaluation is important, the process thorough and the scrutiny and analysis intensive, taking approximately fourteen months. The FATF assesses over forty jurisdictions while the remaining global jurisdictions are assessed by the FATF Regional Bodies in conjunction with the World Bank and IMF. The FATF Plenary considers and adopts only two mutual evaluation reports at each of its three annual Plenary meetings; each assessment cycle therefore comprises eight years.

The FATF’s country assessments carry considerable weight globally. The European Union relies heavily on the FATF findings and reports: European Commission Delegated Regulation (EU) 2016/1675 “...fully acknowledges relevant work already undertaken at international level for identifying high-risk third countries, in particular of the Financial Action Task Force.”

In preparation for such an assessment, a workshop was hosted by the Financial Intelligence Centre (FIC) in March to prepare the different private sector institutions in respect of the nature and extent of information required to demonstrate South Africa’s compliance with FATF standards. The FIC facilitated the pre-assessment training with assistance from an IMF team.

The question is whether South Africa will be found to be compliant with global AML and CTF standards or whether the chickens of corruption and state capture will come home to roost. Showcasing the country’s legislative framework and modern financial sector systems will go far but unfortunately the FATF is going to look for evidence of the effectiveness of investigatory and prosecutorial efforts. As the IMF remarked in its 2015 Country Report: “The fact that to date there have been no convictions involving third-party laundering except in some organized crime cases, and no convictions for the laundering of foreign proceeds of crime, suggests that the potential threat posed by such activities are not adequately investigated or addressed”.

The last assessment of SA by the FATF occurred in 2008, and the Mutual Evaluation Report (MER) was adopted and handed down in 2009. In 2008 the FIC Act had already been amended to proactively align South Africa with the FATF’s evolving standard. This explains why the 2009 Mutual Evaluation Report, applying the 2004 FATF AML/CTF Methodology, praised South Africa’s financial sector as “highly developed” and observed that “South African authorities have established effective mechanisms to cooperate on operational matters to combat ML and FT” and that the “[FIC], law enforcement agencies, and supervisors are able to provide a wide range of international co-operation to foreign counterparts, and generally do so in a rapid, constructive, and effective manner.” It also observed that the FIC “is a well-structured, funded Financial Intelligence Unit (FIU)”.

This time, however, the FATF will no doubt take cognizance of criminal and corrupt activity exposed by the media, as the fourth estate, and the Commissions of Enquiry, and raise probing questions as to why these activities are glaringly absent in the investigative and prosecutorial statistics and reports. It will take notice of the fact that state capture has wiped out a substantial percentage of the country’s GDP with economic growth plummeting concomitantly.

It is noteworthy that the 2009 Report already observed that corruption represented a problem and raised a few cautionary recommendations, namely that the keeping of statistics need improvement and it cautioned that South Africa should review the effectiveness of its systems for combating money laundering and terrorist financing on a regular basis. Throughout the Report, effec-
tiveness was an issue of concern. It recorded that South African Police statistics show a low rate of money laundering investigations and convictions. The result of the 2009 MER was that South Africa was deemed “Compliant” for nine and “Largely Compliant” for 14 of the FATF’s 40+9 Recommendations but the report also raised red flags - noting that SA was “Partially Compliant or Non-Compliant” for two of the six Core Recommendations.

Under a targeted follow-up process, South Africa had to report to the FATF Plenary on the progress made in addressing the deficiencies in the 2009 MER. This sword kept hanging over SA’s head until November 2017 when, as a result of the Financial Centre Amendment Act which came into operation in October 2017, and which inter alia addressed deficiencies relating to customer due diligence (CDD) and record keeping, the FATF at its Plenary meeting in November 2017 refrained from listing South Africa for purposes of its targeted follow-up process. The heat was off, at least for a while.

Meanwhile, in 2013, the FATF adopted a new Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT systems, updated in 2019, a universal standard applicable to all countries. It makes provision for four levels of Technical Compliance:

- Compliant (no shortcomings);
- Largely Compliant (minor shortcomings);
- Partially Compliant (major shortcomings); and
- Non-compliant (major shortcomings).

If a requirement does not apply, due to structural, legal or institutional features of a country, it is rated Not Applicable.

Effectiveness is defined as “The extent to which the defined outcomes are achieved”. The methodology to assess effectiveness is fundamentally different to the methodology to assess technical compliance. The assessment relies on the judgment of assessors analysing and evaluating the evidence of effectiveness provided by the assessed country.

Immediate Outcomes are, inter alia:

- Effective prosecution and proportionate and dissuasive subsequent sanctions;
- Confiscation of proceeds and instrumentalities of crime;
- Terrorist financing offences prosecuted and followed by effective, proportionate and dissuasive sanctions.

The assessors’ conclusions will be descriptive and not a mere statistical exercise. The country’s technical compliance will serve as a point of departure but conclusions regarding effectiveness will be based on an overall understanding of the degree to which a country achieves the listed outcomes. The approach will be qualitative, rather than quantitative. Effectiveness ratings will be as follows:

- High level: Immediate outcome achieved to a very large extent though minor improvements may be needed;
- Substantial level: Immediate outcome is achieved to a large extent though moderate improvements needed;
- Moderate level: Immediate outcome achieved to some extent though major improvements needed;
- Low level: Immediate outcome not achieved (or negligible) and fundamental improvements needed.
It is, therefore, very clear that South Africa’s 2019 MER is going to be a thorough and objective test. Fortunately significant progress has been made to improve the AML/CFT legal and institutional framework since the 2009 MER. However, one cannot help but notice that SA has not yet concluded a National Risk Assessment (NRA) despite the fact that the International Monetary Fund (IMF) unambiguously stated in its March 2015 Country Report that “the authorities are strongly encouraged to press ahead with the NRA as a matter of priority in a cooperative and inclusive manner.” Criticism was also justified from academic authors questioning methodology in identifying activities to be brought within the scope of the Financial Intelligence Centre Act without first doing a proper and comprehensive NRA (Nkhawasalu: De Rebus May 2017).

The link between corruption and money laundering has long been recognised by the FATF and, for evaluation of effectiveness, becomes a very relevant issue: “Effectively implemented AML/CFT measures create an environment in which it is more difficult for corruption to thrive and go undetected.” The FATF Reference Guide and Information Note on Corruption is consistent with the revised FATF Recommendations. In the third round of Mutual Evaluations the FATF included corruption and bribery as one of the predicate offences when considering the number of investigations, prosecutions and convictions for money laundering and the property confiscated during the process.

The heat is on again and it is clear that the South African government is aware of its shortcomings, risk and exposure. In the Media Statement (published in the Government Gazette No 42267 of 28 February 2019) accompanying the invitation for public comments on draft regulations on international financial transactions (s31 of FIC Act) and amendment of regulations on cash transaction reporting and aggregation (s28, FIC Act), the National Treasury acknowledges that “Failure to implement an effective (our emphasis) Anti-Money Laundering and Combating of the Financing of Terrorism (AML/CFT) system weakens the credibility of the South African financial system, undermines the ability to accelerate economic growth and job creation, and compromises the security of the country and its people”. The Treasury refers to South Africa’s current Programme of Action (specifically priorities to intensify efforts to combat crime “including corruption”) and government’s Medium-Term Strategic Framework Outcomes and indicates that the proposed regulations and amendments “seek to improve the generation of quality financial intelligence information so as to assist investigating and prosecuting authorities, and to increase the chances of securing convictions”.

However, will South Africa’s recent efforts pass muster? Why do we not yet have a proper NRA, one wonders? Or is it “too little, too late”? Recent global politicalisation were insufficient. The 2012 TI report categorised South Africa as a country with “no enforcement”, recording no cases or investigations. In March 2016, the OECD Working Group on Bribery raised concerns about South Africa’s lack of enforcement actions and it also noted that few steps have been taken to address concerns that political considerations may influence investigation and prosecution of bribery.

Another globally recognised report, the Corruption Perceptions Index, published annually by Transparency International, gave South Africa a score of 43 in 2018 (in 2016 the score was 45). A score below 50 is indicative of a country struggling with corruption issues.

The 2018 Basel AML Index could provide some insight for purposes of predictive crystal ball gazing. This index is an independent annual ranking that assesses the ML/TF risk around the world. The FATF’s MER’s feeds into the Basel AML Index. Like the FATF, it focuses on AML and CFT plus related factors such as corruption, transparency and the rule of law. It is a research-led composite index based on public sources and third party assessments. Just like the FATF, effectiveness plays a very important role in the Basel AML Index. In the latest Basel AML Index of 2018, South Africa is listed as one of the “top 10 decliners” under the list of countries which have significantly worsened their scores. South Africa’s score has declined from 4.59 in 2017 to 5.34 in 2018, a negative change in score of 0.75.

South Africa has one of the most efficient and modern financial sectors in the world: technical compliance should not present a problem, even when considering the country’s legislative framework. However, one just needs to consider the evidence presented at the current Commissions of Inquiry to realise that there is going to be a huge problem when South Africa’s legal system is assessed for effectiveness.

If corruption has become the country’s biggest obstacle to effective AML/CFT, the FATF will not hesitate to critically point out what needs to be done to become effectively compliant.

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THE BUCK STOPS HERE

NDUMISO DYANTYI AND KEAGILE MATHOBELA

Public Audit Amendment Act
South Africa has been riddled with the mismanagement and mishandling of taxpayer’s monies. Over the years, not only has this led to the erosion of the tax base due to ever increasing unemployment, but there has been an axiomatic and glaring lack of government accountability and transparency.

Allegations of corruption levelled against government employees and public officials has become the order of the day and the consequences that flow from the apparent lack of respect for the rule of law have been hard felt by tax payers, who shoulder the burden of funding the many investigations and commissions aimed at combating corruption; one of the main reasons the country has been downgraded by the ratings agencies.

In an effort to fight the scourge of corruption, the President assented to the Public Audit Amendment Act (5 of 2018) which seeks to amend the Public Audit Act (25 of 2004). Certain sections of the Amendment Act came into operation on 1 April (Proclamation No.13 of 2019, GG 43217). This amendment will grant the office of the Auditor-General South Africa (AGSA) powers to “directly impact” audits and put pressure on government departments, municipalities and SOEs to comply more strictly with the law.

The Act is amended by the insertion of new definitions, granting the AGSA power to act against irregular state spending and to take remedial action to ensure that losses suffered by the state are recovered, and those responsible for such losses are held accountable. The Amendment Act further seeks to empower the AGSA to perform international audit work and to conduct performance audits in an effort to align the AGSA’s governance arrangements to current international best practice.

The Amendment Act inserts a new Part 1A into Chapter 2 of the Act which sets out the procedure to be followed by the AGSA when taking remedial action to address this failure. Where there is a material irregularity that has resulted in financial loss to the state and the accounting officer failed to implement the recommendations, the loss may be recovered from the responsible person. The AGSA must further issue a certificate of debt to the accounting office or accounting authority to repay the state the amount specified in the certificate of debt. Simply put, the certificate of debt becomes a liquid document from the date of issue and it can thus be used to carry out the remedial action.

The authority of the Auditor General
Section 2 of the Constitution, 1996 provides that the Constitution is the supreme law of the Republic and that any law or conduct inconsistent with it is invalid. As such, the obligations it imposes must be fulfilled.

Accordingly, any amendments to the Act must be consistent with the powers afforded to the AGSA by the Constitution. The Institution of the AGSA (Chapter 9 of the Constitution) provides under paragraph 188(1)(b) that the Auditor-General has the authority to audit and report on the accounts, financial statements and financial management of all municipalities. Considering the constitutional
functions and powers of the AGSA, the Amendment Act further empowers the AGSA with the function of debt collection and the recovery process: this may result in an unconstitutional and unlawful function by the AGSA.

According to a submission by the eThekwini Municipality, s5(1B) changes the function of the AGSA from an audit function to a recovery function. This may amount to the AGSA assuming the functions of the executive of the municipal function as the concept of an “undesirable audit outcome”, which is now referred to as a “material irregularity” under s14(g), is legislated by s32 of the Municipal Finance Management Act (56 of 2003) (MFMA). This provides that a municipal officer is liable for unauthorised expenditure deliberately or negligently incurred by the accounting officer. In its submission, the municipality opines that the Amendment Act is a disguised amendment to the Constitution, by granting the AGSA additional powers.

It is unlikely that this constitutional argument against the enactment of s5 of the Amendment Act would succeed in court as the exercise of the AGSA’s public powers is conferred by the Constitution. Furthermore, in President of the Republic of South Africa v Office of the Public Protector and others [2018] JOL 39411 (GP) the Constitutional Court held that as a Chapter 9 Institution, the Public Protector’s remedial action is binding, unless set aside by a court of law. Based on the principle of stare decisis it is likely the same principles will apply for the AGSA’s remedial action.

It is imperative to note that national government should not erode the autonomy of local municipalities, and the autonomy of the spheres of government as envisioned by the Constitution must be preserved, as emphasised by the Constitutional Court judgment in Minister of Local Government, Environmental Affairs and Development Planning of the Western Cape v Lagoonbay Lifestyle Estate (Pty) Ltd and Others [2013] ZACC 39; 2014 (1) SA 521 (CC).

The Act is amended by the insertion of new definitions, granting the AGSA power to act against irregular state spending and to take remedial action to ensure that losses suffered by state are recovered and those responsible for such losses are held accountable.

The interaction of the Public Audit Amendment Act and Companies Act

Section 76 of the Companies Act is a codification of the common law position of directors’ fiduciary duties of care and skill, to act honestly and in good faith. It increases directors’ accountability to the shareholders of the company and expects them to conduct themselves in a manner that is reasonably believed to be in the best interest of the company.

Even more burdensome on the directors are the provisions of s77 which provide that a director may be held personally liable, in accordance with the principles of the common law relating to breach of fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director contemplated, inter alia, in s76 of the Companies Act.

Prior to the Amendment Act, government officials’ conduct was legislated in terms of s38(1)(b) of the Public Finance Management Act (1 of 1999) (PFMA) which requires accounting officers of government institutions to be responsible for the effective, efficient, economical and transparent use of their respective institutions’ resources. Furthermore, s38(c)(ii) of the PFMA authorises an accounting officer to take effective and appropriate steps to prevent unauthorised, irregular, fruitless and wasteful expenditure and losses resulting from criminal conduct. These sections of the PFMA impose a duty on the accounting officer to act reasonably in protecting state finances, without providing for the appropriate consequences that the accounting officer would suffer should he fail to act in the manner prescribed in s38.

The Public Audit Amendment Act is the golden thread that seeks to put government officials on a par with directors by emulating the position crafted in s77 of the Companies Act. Municipal managers and government accounting officials can no longer shrug their shoulders at the mismanagement and material irregularities that result in financial loss to the state. The Amendment Act empowers the AGSA to hold such persons personally liable by issuing a certificate of debt to the accounting officer to repay the amount specified in the certificate of debt. A simple resignation will not absolve the accounting officer from the consequences of a breach of their duties as canvassed under the PFMA and MFMA.

Accounting officers and accounting authorities are, therefore, required to implement control measures to ensure that all expenditure in their respective institutions is necessary, appropriate, cost-effective and is recorded and reported, as prescribed by the relevant legislative framework. The Amendment Act positions the AGSA as the big brother to ensure that accounting officers and accounting authorities adhere to their duties as prescribed by legislation.

Intrinsically, and to ensure good governance, members of the audit committee in any government department and municipality must acquire the knowledge and skill for the position and, more importantly, exhibit integrity and independence when exercising their functions and executing their duties. The Amendment Act is a progressive step in ensuring that taxpayer’s monies are spent diligently with due care and regard. The legislature is hopeful that good governance and accountability are strong pillars in ensuring effective service delivery for South Africans.

South Africa has a well-developed legal framework to curb corruption and it is vital to strike a balance between all pieces of legislation as they continuously interact with each other. The Amendment Act will substantially alter the current legislative framework of the office of the AGSA, the state of affairs of the country and will see to the efficient management of the public purse.

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COMBATING MONEY-LAUNDERING AND TERRORISM FINANCING IN EAST AFRICA

I. MUNGAI KAMAU AND JACQUELINE WANGUI

Money laundering and terrorism financing pose momentous threats to security and development efforts worldwide and progressively undermine the integrity of the global financial system. Just like terrorism financing, money laundering thrives on anonymity and opacity, which is why the United Nations Office on Drugs and Crime describes it as “the process that disguises illegal profits without compromising the criminals who wish to benefit from the proceeds.” Money laundering accounts for up to 5% of global GDP - or $2tn (£1.5tn) - every year, according to the UN.

Although money laundering does not require the use of formal financial institutions, statistics suggest that financial institutions are favoured avenues of laundering proceeds obtained through criminal activity. Disguising the origin of money to make it appear to have been derived from a legitimate source is what allows criminals to realise the benefits of their crimes.

The Financial Action Task Force on Money Laundering (FATF) is an intergovernmental body established by the 1989 G7 Summit in Paris. Its primary responsibility is to develop a worldwide standard for anti-money laundering and to combat any related threat to the international financial system, including terrorism financing. The organisation works in close co-operation with other key international bodies including the World Bank, the International Monetary Fund, the UN, the African Development Bank, 38 member states and nine FATF bodies that essentially interlink and cover all continents.

The FATF standards require countries, territories and regions to criminalise money laundering, terrorist financing and proliferation financing in accordance with international law. They are also required to freeze terrorist assets, confiscate proceeds of crime and establish financial intelligence units that track suspicious transactions. Due to the growing international dimension to these crimes, better co-ordination and co-operation among national agencies, as well as greater levels of international co-operation, are part of the solution.

Africa has four FATF bodies that connect the entire continent. East Africa’s jurisdiction falls under the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG).

In Eastern Africa, only Eritrea and Burundi have not subscribed to FATF; that notwithstanding, in recent years there has been increasing political will and tangible progress on anti-money laundering and countering the financing of terrorism issues in the region.

The fight against terrorism in Kenya

Kenya’s Proceeds of Crime and Anti-Money Laundering law came into force in 2010, with punishments including monetary fines and jail time. The law also established an asset recovery unit charged with tracing and seizing crime proceeds. The integrity of Kenya’s financial system recently came under scrutiny in the wake of the January 15 terrorist attack on Nairobi’s upscale dusitD2 hotel. Investigations revealed that one of the suspects transacted approximately $1 million through mobile payment services a few months before the attack. A second suspect received over $90 000 from South Africa through a mobile payment system and channelled the funds to terror suspects through 47 SIM cards. The attack, which claimed 21 lives and many injuries, exposed the deficiency in financial systems regulations in the region, particularly the regulation of mobile money platforms and emerging virtual financial systems.

The country’s law also established an asset recovery unit charged with tracing and seizing crime proceeds. Earlier this year, its Attorney General, Paul Kihara reported a recovery of $30 million from proceeds of corruption and money laundering. However, he also noted his concerns that advance-
ments in technology had made it easy to move and hide illicit funds, with terrorism continuing to gain prominence.

Why Kenya is replacing its banknotes
In June, in an unprecedented move, the country’s Central Bank Governor, Dr Patrick Njoroge, an ex-IMF adviser, announced the withdrawal of the highest denomination KES.1 000, noting the big currency banknotes are being used for illicit financial flows in Kenya and other countries in the region.

The demonetisation and subsequent introduction of the new currency is expected to help greatly in the fight against corruption. There are numerous instances where people have been nabbed with large sums of money suspected to be illegally acquired. The discovery by law enforcement agencies of huge amounts of high denomination notes stashed in people’s houses and even in bank safes is an indication that there is a substantial amount of illicit money circulating in the Kenyan economy.

Officials and well-connected businessmen in corrupt cartels are believed to be hoarding hundreds of millions of illegally obtained currency in cash. Withdrawing the KES.1 000 note is expected to close many money-laundering avenues, as all validly acquired notes have to be exchanged for the new currency, leaving those with illicit funds stranded with worthless paper money. Those exchanging less than KES5m would be able to do so at their local bank but any higher amounts will need approval from Kenya’s central bank.

Kenya’s Western neighbour, Uganda
Until 2017 Uganda was included in the money laundering “blacklist”, which is reserved for countries with weak anti-money laundering laws. Only when Uganda’s parliament passed legislation requiring disclosures to be made on transactions of US$100M and above, was it removed from the blacklist.

There remains a notable gap in the regulation of e-banking in Uganda. The country’s laws place an emphasis on monitoring cash transactions with little focus on electronic payment systems. This gap is significant because most banks in Uganda offer mobile banking services, and a majority of Ugandans use these services. It therefore becomes easy for money launderers to conceal their activities, given the virtual nature of mobile money and often high-levels of anonymity. Uganda does not have legislation tailored towards supervision of mobile money services. Under the prudential guidelines of the Bank of Uganda, the duty to guard against money laundering is largely placed on mobile money service providers—and there are no detailed procedures to ensure they comply with this self-reporting duty.

Ethiopia makes it to EU’s ‘weak anti-money laundering regime’ list
In February this year, the European Commission added Ethiopia to the list of countries with weak anti-money laundering and counter-terrorism financing regimes. This sparked a protest by the country’s Prime Minister, Abiy Ahmed. A total of 23 countries were listed by the Commission, including war-torn Libya, Tunisia, Botswana and Ghana. Africa’s biggest economy, Nigeria, also made it to the list alongside Yemen, Syria, Afghanistan, North Korea, Iraq and Iran.

The European Union decréd these countries’ banking systems which have loopholes that could facilitate money laundering, illicit financial flows and terrorism financing. As a result of the listing, banks and other entities covered by EU anti-money laundering rules will be required to apply increased checks on financial operations involving customers and financial institutions from these high-risk countries to identify any suspicious money flows better.

The changing face of money laundering: staying ahead of the game
Money laundering techniques have become so sophisticated that the operators remain steps ahead of law makers and enforcement agents.

For developing countries, the weak link in anti-money laundering and counter terrorism financing efforts is evident in legislation which is designed mainly to address traditional banking and financial institutions. The rise of online banking institutions, anonymous online payment services and peer-to-peer transfers with mobile phones have made detecting the illegal transfer of money even more difficult.

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EVERYONE’S CUP OF COFI?

THATO MKHIZE AND WILDU DU PLESSIS

It is fair to say that there has been a steady increase in financial sector conduct regulation over the past decade, not only in South Africa but indeed globally. Some financial industry experts are of the opinion that this is evidence of a true paradigm shift towards the redesign of the global financial industry.

In South Africa, different regulators have implemented different methods for regulating the conduct of financial institutions. For example, the Competition Commission’s market enquiry into the retail banking sector, the introduction of the draft Treating Customers Fairly principles and the implementation of a Twin Peaks model of financial sector regulation through the promulgation of the Financial Sector Regulation Act in 2017, are among some of the notable efforts made by regulators and legislators to contribute to a financial sector that is inclusive and receptive of new market entrants.

In 2018 a working group established by National Treasury gathered once more to reflect on the foundations laid by previous legislation in regulating the conduct of financial institutions in South Africa. The outcome of that discussion was a new piece of legislation that aimed to provide a consolidated regulatory framework for the conduct of financial institutions - the Conduct of Financial Institutions Bill or COFI.

COFI proposes a consolidated financial sector regulatory framework that will not only be applicable to financial services or products but also to supervised entities that have not traditionally been defined as financial institutions. This is to eliminate the silo approach and regulatory arbitrage that often comes with the implementation of fragmented financial sector regulation. Further, COFI proposes to transform the licensing process and requirements for financial service providers, introducing gradual compliance with current licensing requirements, after application to the relevant authority. It also echoes the activity-based approach to licensing of financial institutions, which is followed by the newly established Financial Sector Conduct Authority (FSCA).

Financial service providers are often concerned with the increased burden of compliance when faced with new legislation. Although COFI presents con-
solidated compliance requirements and principles contained in other pieces of financial legislation, financial services providers will be expected to comply with requirements and obligations unique to COFI. Notably, COFI proposes substantial changes to the conduct of the financial institutions in their approach to regulatory compliance and customer services.

In addition to the new licensing framework already mentioned, COFI focuses on the corporate culture of financial institutions, as well as the processes and procedures governing its financial products and services. Financial institutions, in their efforts to promote a sound corporate culture, are expected to entrench principles of fair treatment of customers, promotion of customer-appropriate financial products and services, and to enhance transparency in dealings with customers. These are familiar concepts within the financial sector. Accordingly, financial institutions would merely have to reflect on the governance procedures and processes, which are already in place, and establish whether there are compliance gaps and how the consequential risk could be minimised.

Further, in addressing the culture and governance of financial institutions, COFI addresses the potential risks that emanate from their core business - the provision of financial services and products. As observed in the Financial Advisory and Intermediary Services Act, COFI proposes principles such as transparency, efficiency and suitability, which promote the interests of the financial customer, and are flexible enough not to hinder or cripple innovation. Financial institutions are expected to design products and provide services which are customer-centric, are subjected to a product approval process led by senior management, and are regularly reviewed to ensure alignment with the product oversight arrangements. COFI requires that these compliance requirements should be reflected in the institution’s governance policy, and that compliance with such policy and procedures should be monitored on an ongoing basis.

COFI is explicit in its support of transformation. Its definition of transformation is aligned to the BBBEE Act, and transformation is included as one of its main objectives. The Explanatory Paper on COFI states that financial institutions will be required to report on the implementation of their transformation policies to the FSCA. This emphasises the fact that financial institution conduct in South Africa is no longer considered to be mutually exclusive from the implementation of transformation in the financial industry.

Through COFI and its predecessors, financial sector regulation in South Africa has already achieved noteworthy strides in its effort to ensure a stable financial services sector. The successful implementation of the principles of COFI has the potential to further transform the industry and open the market to competition, increasing the options available to consumers. And hopefully, with customers’ needs already the core focus of the business strategies of the majority of financial institutions in South Africa, complying with these regulations should not be too onerous.

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IS THERE A TIME LIMIT FOR CONCLUSION OF A NCA CREDIT AGREEMENT?

DEAN RAATH

Background

Before concluding a credit agreement, a credit provider must provide a consumer with a quotation which (with a few exceptions) is open for acceptance by the consumer, for five business days. The quotation reflects the credit approval and constitutes a specific credit offer which binds the credit provider for those five days.

A quotation must, therefore, be preceded by a credit assessment to prevent reckless lending. The assessment must include consideration of the customer’s debt repayment history “within 7 business days immediately prior to the initial approval of credit”[Reg 23A(13)].

The problem

Is there a time limit to the conclusion of a credit agreement after a quotation is provided? More specifically: if the consumer wants to accept the quotation “after the 5 business days have expired” (when it is no longer binding on the credit provider), can the credit provider still conclude the credit agreement?

Analysis

The National Credit Act [NCA] refers to both “days” [for example in s71] and “business days” [as in s92]. Therefore these words should be interpreted according to the specific wording used in a particular context.

In terms of s92(3), read with the prescribed forms, it is clear that the five business day period is a minimum period obliging a credit provider to conclude a credit agreement, if the customer accepts the quotation during that time. However, the five day period is arguably not, at the same time, a maximum period to do so, for the following reasons:

- The basic principle in contract law is that no formalities are required for the conclusion of contracts. Legislation changing that must do so in clear terms or by necessary implication. A time limit for conclusion of an agreement will be such a formality. Section 92 clearly introduces a minimum period, but does not introduce any time limit for conclusion, either in clear terms or by necessary implication.
- If strict compliance with the five business day period was required, especially
if it was a valid requirement for a credit agreement, one would expect clear consequences for non-compliance. Nothing has been provided in this regard.

- Section 89 deals with unlawful credit agreements and provides both a fixed list of instances which will result in credit agreements being unlawful, and the resulting consequences. Non-compliance with the five business day period is not included in this fixed list.

- Courts have confirmed several times that the interpretation of the purpose of the NCA, as set out in s3, is very important. Accordingly, an interpretation that supports the purposes of the NCA should be applied. Two of the NCA purposes are (i) to provide customers with information that allows them to make informed decisions (this should enable customers to compare quotes from different credit providers); and (ii) to make credit more accessible. Treating the five business days as a maximum period may defeat these purposes if a customer, who otherwise qualifies for credit, is declined simply because the quote is accepted on, for example, day six or if he is “rushed in” to make a wrong decision (such as a more expensive one), simply to meet the five business day period.

The absence of a specified maximum period does not mean that a quotation, once issued, will remain valid indefinitely. The prohibition against reckless lending provides guidance:

- Section 80(1) states that a credit agreement is reckless if, “at the time the agreement was made”, the credit provider fails to conduct an assessment as required by s81(2). This cannot literally mean that the assessment must be done at the time of conclusion, because at conclusion a credit assessment must have already been completed, a credit decision taken, a quotation issued and communicated to the customer, and five business days afforded. However, it certainly indicates that assessment, quotation and conclusion must be done in close proximity to the conclusion.

- Section 81(2) requires a credit provider to take reasonable steps to assess, amongst others, the consumer’s debt re-payment history as a consumer under credit agreements before entering into a credit agreement. That is just one step to be complied with as part of the credit decision-making process. It necessarily takes time to meet all requirements.

These general requirements are, in effect, also time limits (albeit without specific time frames). A credit agreement should be concluded as soon as possible after the assessment, and the quotation provided to ensure the credit provider can show that at the time of conclusion, it was (still) reasonable to assume (that is, meeting the reasonable steps requirement) that the information used for the earlier credit assessment and quotation remains current, valid and accurate.

- Failure to meet this test will result in reckless lending.
- A credit provider may impose for itself an additional maximum number of days after the five days during which it will still conclude a credit agreement. This will depend on a credit provider’s subjective risk appetite, bearing in mind the s80 - 81 requirements.

Are there additional requirements if conclusion happens after five business days?

More specifically, should the debt repayment history check obtained within seven business days immediately prior to the initial approval of credit be refreshed before conclusion of the credit agreement?

The answer seems to be “no”:

- The presentation of a quotation certainly indicates approval of credit because of its binding nature on a credit provider;
- The NCA itself does not deal with any direct obligation or time period, as far as “credit bureau information” is concerned. Rather it states in general terms the credit provider’s obligation, as far as over-indebtedness is concerned, to determine an applicant’s probable propensity to satisfy in a timely manner all obligations under all credit agreements, as indicated by the consumer’s history of debt repayment [s79(1)] – this probably refers to a credit bureau check. This requirement is repeated in general terms with reference to a credit provider’s obligations to avoid reckless lending [s80 – 81].
- The NCA regulations were amended with effect from 13 September 2015. Among others, Reg 23A(13) was introduced but, since it cannot amend the Act, at best it provides more clarity on what the provisions in the Act have meant all along. It requires a credit provider to take into account a consumer’s debt repayment history under credit agreements as envisaged in s81(2)(a) and must ensure that this requirement is performed within seven business days (14 in the case of mortgages) immediately prior to the initial approval of credit or an increase to an existing credit limit. Once again, although there is no direct reference to “credit bureau information”, read with the definitions of “discretionary income” and “necessary expenses” [s1, Regulations], in the wider context of these regulations, it most likely refers to “credit bureau information”.

The NCA neither specifies nor implies a specific time limit for the conclusion of a credit agreement. Although it can be done after the five business day period has expired, it is recommended that it be done as soon as possible thereafter.
• Reg 23A(13), read with s92, means that the Legislature/Minister accepted a **minimum time lapse** of 12 business days [seven plus five, or 14 plus five business days in the case of mortgages] from checking the credit bureau information until the last moment that a credit provider will be bound by a quotation, notwithstanding that info could have changed during this time.

• The Legislature/Minister therefore regards these time delays as still being acceptable for the conclusion of a credit agreement, and compliance with the NCA and Regulations, without introducing additional requirements. Put differently, such a time delay then clearly meets the requirements of s80 – 81.

• Accordingly, there is no requirement in either the Act or Regulations that credit bureau information should be refreshed during these delayed periods.

• Nothing prevents a credit provider from refreshing information after the five day period before concluding a credit agreement. That will depend on the likelihood of it still being able to claim compliance with s80 and s81, actual knowledge of a change in customer information, etc. The longer the period, the bigger the risk of non-compliance with these sections.

The NCA neither specifies nor implies a specific time limit for the conclusion of a credit agreement. Although it can be done after the five business day period has expired, it is recommended that it be done as soon as possible thereafter. No specific number of days can automatically be regarded as acceptable or unacceptable. The real test is compliance with s80 and s81.

It is advisable for a credit provider to adopt a policy to limit the conclusion period to a specific number of days after the five business days, before information refreshment is required.

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**KEEPING UP WITH COMPETITION LAW: KEY DEVELOPMENTS ACROSS AFRICA IN THE FIRST HALF OF 2019**

**Mmadika Moloi and Edwina Warambo**

Although we are only halfway through the year, there have already been significant competition law developments across Africa. A number of new authorities have become operational and various legislative changes have been effected, impacting the competition law landscape in several jurisdictions. All these changes are a reflection of the need for developing countries to not only have competition law but to also ensure that competition law is effective for competition regulation in a globalised economy. Keeping abreast of these developments is essential in mitigating regulatory risks.

**Mergers**

In relation to newly established authorities, the Moroccan Competition Council and the Competition Regulatory Authority in Angola are now effective and fully operational. New competition laws have been enacted in Botswana and Nigeria. In 2018, the president of Botswana assented to the Competition Act (17 of 2018) (the New Act), however, the effective date is yet to be announced. In terms of the New Act, cartel conduct has been criminalised and implicated directors and employees may face up to five years in prison or pe-

Financial institutions depend on their ability to attract and harbour legitimate funds. It is imperative, therefore, that they cultivate a culture of compliance with anti-money laundering and counter-terrorism financing laws to curb the abuse of the mainstream financial system, especially since law enforcement agencies rely heavily on financial institutions’ first hand detection and reporting of the crimes.
cuniary fines. Prior implementation of mergers may now also be punished by the imposition of a fine of up to 10% of the purchase consideration or the combined turnover of the merger parties (whichever is higher). In Nigeria, the Federal Competition and Consumer Protection Act (the FCCPA) was passed into law in January. The FCCPA establishes the Federal Competition and Consumer Protection Commission (the FCCPC), which is responsible for merger review, consumer protection and investigations in relation to anti-competitive practices. The Securities and Exchange Commission (the SEC) was the body previously tasked with merger control. A transition period was established from 3 May, until the issuance of further advisory or guidance by the FCCPC, during which all applications relating to mergers will be received jointly by the SEC and the FCCPC, while the application fees will be paid to the FCCPC, which will also be responsible for conveying the decision on the filing.

Without prejudice to the investigatory activities that these new competition authorities are likely to undertake in the future, it is expected that the most immediate enforcement of the competition laws in the different jurisdictions will, in all likelihood, relate to merger control.

A significant amount of focus continues to be placed on public interest considerations, not only in South Africa but across the African continent, resulting in a number of mergers being approved subject to public interest conditions. Whilst most public interest conditions relate to employment, there is a shift towards the imposition of other public interest conditions such as promoting localisation. In Botswana, the Competition Authority approved the proposed acquisition of 50% of the issued shares in Dennis Service Station from Gavin Blackbeard by Ngami Motors, on condition that the shareholding in the business of Dennis Caltex Service Station is allocated as 51% for citizen(s) and 49% for non-citizen(s).

In Kenya, the Competition Authority of Kenya (CAK) is also beginning to look beyond the impact of mergers on employment. In the transaction involving Total Kenya and Gulf Africa Petroleum Company, the CAK imposed a condition requiring Total Kenya to strike out anti-competitive clauses in agreements with dealers.

In South Africa, there is a continued trend towards supporting the growth of small and medium enterprises - the South African Competition Commission (the SACC) recently approved the proposed merger between Experian SA and the CSH Group, subject to conditions requiring Experian SA to provide technical support and set up a Technical Support Fund that will empower smaller bureaus to provide consumer credit services to banks, and recommended that the entities should make an investment commitment to introduce new innovative products.

Regional authorities

There have also been developments in relation to regional competition bodies. The East African Community Competition Authority has appointed Dr. John K. Mduma as its Commissioner with effect from 13 June.

In addition, on 31 May, the Commission of the Economic Community of West African States (ECOWAS) launched the ECOWAS Regional Competition Authority (ERCA), in Banjul, The Gambia. The ERCA is established to implement the ECOWAS Regional Competition Rules (the Rules) adopted in 2008. The purpose of the Rules is essentially to promote, maintain and encourage competition and enhance economic efficiency in production, trade and commerce in the region. Speaking during the launch, the Vice President of the ECWA indicated that the authority will focus on four major areas of anti-competitive conduct: agreements and concerted practices in restraint of trade, monopolisation practices, mergers and acquisitions as well as “State induced” competition distortions.

It will be interesting to see the effect that these regional bodies have on competition law in East and West Africa and whether they will contribute to promoting effective competition in these regions, particularly in instances where regions are already covered by strong regulators such as the CAK, the Fair Competition Commission of Tanzania and the Common Market for Eastern and Southern Africa (COMESA) Competition Commission.

Market inquiries

There are several market inquiries that have been initiated/completed in the first half of 2019. In Zimbabwe, owing to an increased number of consumer complaints related to high charges, parliament commenced an inquiry into mobile data costs in February. In addition, the Competition and Tariff Commission announced the commissioning of a market inquiry into the school uniforms sector after it became aware of allegations of anti-competitive practices in the supply and distribution of school uniforms, including, among others, compelling parents/guardians to buy from a specific supplier, tying and bundling.

In South Africa, the SACC released a provisional report on its Data Services Market Inquiry in April and also recently released the provisional findings of its inquiry into South Africa’s grocery retail market. The final report on the data inquiry is expected in December, while it is anticipated that the final report on the grocery retail market will be released at the end of September. The SACC market inquiry into the land-based public passenger transport sector is also expected to be complete by the end of September. A key challenge for the authorities will be to propose appropriate recommendations and policies in an attempt to address concerns identified in the respective markets.

As the world shifts towards liberalised economies, countries across the continent may need to embrace competition law as a key tool to their economic development. With an increase in M&A activity and the development of various economies, we anticipate that the enforcement of competition laws will increase to promote effective competition and regularise markets in the region. It is inevitable that there will be several other developments to monitor as we enter the second half of 2019.

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In handing down its judgment on a jurisdictional challenge in the case between Vedanta Resources PLC and another v Lungowe and others [2019] UKSC 20 (Vedanta) on 10 April 2019, the United Kingdom Supreme Court may very well have dramatically raised the risk of potential exposure of holding companies relating to the operations of their subsidiaries and joint ventures.

In July 2015, a group of some 1 826 indigenous and poverty-stricken Zambian citizens living in the Chingola District launched proceedings in the UK Courts against Vedanta, a London-listed corporate, and Konkola Copper Mines PLC (KCM) in respect of alleged harm to their health and activities arising out of toxic emissions into waterways from the nearby Nchanga Copper Mine, one of the largest open cast mines in the world, over several years.

The mine is owned by KCM, incorporated in Zambia. It employs approximately 16 000 people.

Vedanta, the ultimate parent company of KCM, is incorporated in the UK, and employs 19 people of its own. The group, however, employs over 82 000 people throughout the world.

The claimants alleged that Vedanta was liable for the “wrongdoings” of KCM as it had exercised sufficient control and direction over KCM’s activities and operations.

So why is this case so interesting?

- It raises the risk for parent companies to attract direct liability for the actions and operations of its foreign subsidiaries;
- It promotes substantial justice to the decisive factor in identifying the “proper place” to consider the case as a whole; and
- It reminds litigants of the requirements of proportionality and economic factors involved in relation to jurisdictional challenges and precise questions of law.

The striking element of this particular case was that the Supreme Court found that Zambia would have been the proper place for the litigation as a whole, as all connecting factors indicated this, and the fact that Vedanta had submitted to the jurisdiction of Zambia provided that substantial justice would be available to the parties. Accordingly, the human rights element prevailed, and the Supreme Court found that the claimants would not have been able to obtain substantial justice given the lack of legal aid in Zambia, the fact that the claimants could not enter into a conditional fee agreement with legal practitioners as it is prohibited in Zambia, and the lack of suitably experienced legal teams in Zambia to handle litigation of such complexity and size.

In order to determine whether the claim could be tried in the UK against both Vedanta and KCM, the Court was required to determine whether a triable issue, based on negligence, in fact existed against Vedanta.

In determining the existence of a triable issue, the Supreme Court held that a real triable issue would rest upon whether a “duty of care” existed between a parent company and affected parties in relation to the actions and operations of its subsidiary.

The critical question which was raised in the proceedings was “whether Vedanta sufficiently intervened in the management of the Mine owned by KCM itself (rather than by vicarious liability) such that it owed a common law duty of care to the claimants in connection with the escape of toxic material from the mine alleged to have caused the relevant harm”.

The Court held:
1. “The level of intervention...requisite to give rise to a duty of care... is (as agreed) a matter of Zambian law, but the question whether that level of in-
2. “the liability of parent companies in relation to the activities of sub-

sidiaries is not of itself a distinct category of liability in common law negli-
gence. Ownership of subsidiaries may enable parents to take control of
the management of the operations of the relevant business owned by the
subsidiary but it does not impose any duty upon the parent to do so. All
that the existence of the parent subsidiary relationship shows is that the
parent has an opportunity to do so but nothing more”;

3. “everything depends on the extent to which, and in the way in which, the
parent availed itself of the opportunity to take over, intervene in, control,
supervise or advise the management of the relevant operations (including
land use) of the subsidiary”;

4. “Parent companies and their subsidiaries are separate legal persons and
the four indicia of a duty of care provided by the Court of Appeal in Chan-
dler v Cape PLC [2012] 1 WLR 3111 did not lay down a separate test dis-
tinct from the general principle for the imposition of a duty of care in
relation to a parent company. The Chandler indicia are no more than par-
ticular examples of circumstances in which a duty of care may affect a
parent and did not identify a wider basis in law for the recognition of
the relevant parental duty of care than the law actually provides”; and

5. “the published materials in which Vedanta asserted its own assumption of
responsibility for the maintenance of proper standards of environmental
controls over the activities of its subsidiaries, and in particular the opera-

tions at the mine, and not merely to have laid down but also implemented
those standards by training, monitoring and enforcement, were sufficient
on their own to show that it was arguable that a sufficient level of interven-
tion by Vedanta in the conduct of operations at the mine may be demon-
strable at trial after full disclosure of the relevant internal documents of
Vedanta and KCM and of communications passing between them”.

As such, the Supreme Court found it arguable that a sufficient level of in-
tervention by Vedanta may be shown at trial, after “full disclosure” of relevant
internal documents and communications.

It will be extremely interesting to see how the Court deals with the merits
of the case. At this stage, it is important to take cognisance of the effect of
the judgment, as the more a parent company sets policies for subsidiaries,
and implements them by training, monitoring and enforcement, the more
likely it will owe a duty of care to persons harmed by the subsidiary. However,
as the duty of care is only a threshold, the claimants will still be required to
prove negligence, harm, causation and damages in order to succeed.

Could this be the precursor to further evolution of the common law of
delict? Only time will tell.

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SUB-PARTICIPATION TRANSACTIONS IN AFRICA

BRIAN SHONUBI AND LISA ELLEFSEN

The issue

It is generally accepted that debt transactions in Africa are expensive for bor-
rowers, and risky for the lenders. There are various reasons why debt is com-
paratively expensive on the African continent but generally we find that it is
related to the perception of risk – “What are the chances that I will get my
money back with the expected interest in the normal course of business?”
Risk, which can be a function of economics, politics or regulations, can be
mitigated by lenders in many ways and one of the methods, which we shall
explore in this piece, is through sub-participation transactions.

Sub-participation

Sub-participation allows lenders to sub-contract to other third party financial
institutions all or part of their risk under their loan agreements. The parties
execute a sub-participation or participation agreement; the lender in its ca-
pacity as principal lender or grantor and the third party financial institution in
its capacity as sub-participant. The relationship between the two financial in-
stitutions is that of debtor-creditor.

There are two types of sub-participation: funded participations and risk
participations.

Funded participations require the sub-participant to fund the principal
lender upfront so that it can fulfil its lending obligations under the underlying
loan agreement. The principal lender pays a fee as consideration for this fund-
ing and pays over proportionate principal and interest to the participant as it is
repaid by the borrower.

In contrast, in a risk participation arrangement the parties agree that the sub-
participant will reimburse the principal lender for amounts unpaid by the borrower
following a payment default under the loan. A fee is paid by the principal lender to
the sub-participant under this transaction which operates more like a guarantee.

Some of the benefits of sub-participation

A funded participation allows the principal lender to move part of the risk off
its balance sheet, thus freeing up capital for other ventures. Funded partici-
ations also enable the principal lender to make a profit by transferring the
loan but retaining a percentage of the margin. At the same time, the sub-par-
participant is able to collect a fee for its participation. Through sub-participation,
participants can access markets and deals where they would otherwise not
be able to due to balance sheet restrictions (like single borrower limits), re-
strictions on tenor of loans or local funding requirements.
Funded participations require the sub-participant to fund the principal lender upfront so that it can fulfil its lending obligations under the underlying loan agreement. The principal lender pays a fee as consideration for this funding and pays over proportionate principal and interest to the participant as it is repaid by the borrower.

Development Finance Institutions (DFIs) and commercial banks can use participation arrangements to leverage off their strengths to overcome some of the usual constraints to funding including: restrictions on tenor (which is a common issue for commercial banks that will not usually commit funds for more than five to seven years at the most); political risk (by using the DFIs preferential repayment terms often as a function of Bilateral Investment Treaties (BITs)); or changing the risk profile of transaction (which in theory could make deals cheaper). The firm has successfully used participation inspired structuring and some innovative drafting on recent transactions in order to fund long term projects and incorporate all these benefits.

Potential risk in sub-participation transactions
There is a no-recourse risk in both funded and risk participations because the participant does not hold a direct contractual relationship with the borrower or to the security held to the benefit of lenders, unless this is expressly agreed or rights of elevation (in funded participations, the right to - subject to certain conditions - become a lender of record) or subrogation (in the case of risk participations where there is a payout), respectively, are used.

Participants in funded participations take a double credit risk: one against the borrower which has an obligation to pay the principal lender, and one against the principal lender which has an obligation to pay-over monies received to the participant from the borrower. This may also be the case with risk participations if payment of the risk fee/premium is conditional on funds being received by the principal lender from the borrower.

It is noteworthy that risk participations may not benefit from off-balance sheet treatment and that there may be some risk of amendments or waivers or rescheduling of repayments, restructuring or re-organisation of the indebtedness (in the underlying documents) not carrying through to the participant – if not expressly drafted into the participation agreement.

Managing the risk in sub-participation transactions
Participants can manage their risk in several ways including, for example, negotiating rights to the lender(s) security package to be recognised as a secured creditor. Alternatively, (or in addition) the participant might take security over a principal lender’s right to receive payments from the borrower. Note that in some jurisdictions these arrangements may require borrower consent to the assignment/cession and/or the splitting of claims.

The participant might also consider requiring the principal lender to provide some form of credit support or alternatively, to assign its rights to any existing credit support to the participant (consent may also be required in this instance).

We have already considered the option to elevate in the case of funded participations but it should be noted that even when elevation provisions are included, the participation transaction may still be subject to any transfer restrictions in the underlying documents.

Because of the flow-through nature of participation transactions, it is important that (as far as possible) potential participants undertake a due diligence of the underlying documents and obtain advice, particularly when negotiating rights or adding bespoke provisions to the standard documentation.

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THE TWIN PEAKS MODEL OF FINANCIAL REGULATION IN SOUTH AFRICA

TANYA POLLAK AND ALISTAIR GOBLE

On 21 August 2017, as a result of the enactment of the Financial Services Regulation Act (9 of 2017) (FSRA), the financial regulation system in South Africa was transformed. It was divided into two distinct regulatory sectors, namely, prudential regulation (regulated by the Prudential Authority (PA)) and conduct regulation (regulated by the Financial Sector Conduct Authority (FSCA)). The new financial sector regulatory model is commonly referred to as the Twin Peaks model.

The introduction of the PA, which operates within the South African Reserve Bank (SARB) administration, resulted in the dissolution of the banking supervision department of SARB. The purpose of the PA is to enhance the safety and soundness of financial institutes and maintain financial stability. The FSCA, which replaces the Financial Services Board, regulates how financial services firms conduct their business, and monitors their fair treatment of customers.

The promulgation of the FSRA signified the first step in South Africa’s adoption of the Twin Peaks regulatory model that seeks to promote a more proactive and integrated approach to finance regulation, with less reliance on prescriptive laws and additional focus on overarching broad-based outcomes which corporate entities must demonstrate they are achieving.

The FSRA is the precursor to phasing out of industry-specific legislation. To this end, in December 2018:

- A draft Conduct of Financial Institutions Bill (CoFI Bill) was published for comment. The Bill envisages not only the replacement of conduct provisions in existing financial sector laws, but aims to build a consistent, strong and effective market conduct legislative framework for all institutions performing financial activities.
- The National Payment System Department (NPSD) of SARB and National Treasury published a policy paper, the “Review of the National Payments System Act 78 of 1998”. The paper calls for a redress of the NPSA at a time when the payments industry is moving towards a digital age and is becoming increasingly innovative, and financial technology more adv-

The FSRA requires financial sector regulators (such as the PA, FSCA, Financial Intelligence Centre and the National Credit Regulator), together with SARB, to co-operate and collaborate when performing their functions in terms of financial sector laws such as the National Credit Act (34 of 2005) and the Financial Intelligence Centre Act (38 of 2001). In order to facilitate this, the FSRA established the Financial System Council of Regulators (FSCR). The FSCR is a forum in which senior officials of the financial sector regulators are able to address industry-wide concerns and ensure that there is consistency in action between the financial sector regulators.

The promulgation of the FSRA signified the first step in South Africa’s adoption of the Twin Peaks regulatory model that seeks to promote a more proactive and integrated approach to finance regulation, with less reliance on prescriptive laws and additional focus on overarching broad-based outcomes which corporate entities must demonstrate they are achieving.

Fintech

Financial technology (fintech) remains an unregulated landscape in South Africa. The SARB and the FSCA, while open to discussions in respect of developments within the fintech space, have not yet established any regulatory sandboxes for purposes of assessing the regulation of fintech. Notwithstanding this, the SARB is particularly alive to developments within the cryptoco-
currency and blockchain space, and has supported recent initiatives from various commercial banks to test blockchain applications.

**Depositor insurance**

South Africa does not currently have a system for depositor protection that guarantees depositors’ money in the event of a bank failure. Nevertheless, in May 2017, the SARB published a discussion paper in which it motivated the need for an explicit, privately-funded deposit insurance scheme (the DIS Paper). According to the DIS Paper, the main policy objective of a DIS for South Africa is to protect less financially sophisticated depositors in the event of a bank failure, thereby contributing to customer protection and enhancement of the stability of the South African financial system. Historically, government has compensated depositors for their losses. According to the SARB, a need for a DIS has been further intensified by government’s unwillingness to carry the cost of the failures of banks, and uncertainty about the processes, or lack thereof, for compensating depositors.

South Africa has joined the likes of the United Kingdom, the Netherlands and Australia in adopting the twin peaks model of financial sector regulation.

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**ARE WE ONE STEP CLOSER TO THE ADVENT OF A SARB DIGITAL CURRENCY?**

**B R I D G E T  K I N G  A N D  J A M E S  P E A R T**

**Historical position on e-money**

As far back as 2009, the South African Reserve Bank (SARB) outlined its position on the concept of e-money. In its position paper published at the time, SARB defined e-money as “monetary value represented by a claim on the issuer”. E-money is “stored electronically and issued on receipt of funds, is generally accepted as a means of payment by persons other than the issuer and is redeemable for physical cash or a deposit into a bank account on demand”.

The SARB considered e-money to be a supplement to physical notes and coins in the long term, and committed to, among other things, supporting the development of a banking industry vision for electronic substitutes for physical banknotes and coins, and participating in initiatives aimed at providing secure payment instruments for the general public.

**Feasibility project**

This commitment has come to fruition in the form of the SARB’s latest step towards the possibility of a domestic central bank digital currency (CBDC). On 29 April, the SARB released an Expression of Interest document, which was targeted towards “prospective solution providers in anticipation of a feasibility project for the issuance of electronic legal tender”.

On the back of initial research and investigations performed by the SARB on the case for a CBDC, and on the various forms of public and private virtual currencies, as well as the potential implications should a central bank opt to issue a CBDC, the SARB issued an Expression of Interest for a feasibility project. According to the document, the feasibility project is aimed at deepening the understanding of the implications of issuing a CBDC as electronic legal tender. CBDC is intended to serve alongside cash, not to replace it. The SARB wishes to consider these implications from a policy, technology and operational perspective.

The feasibility study will consist of two phases. The first will be internal to the SARB environment, whilst the second will be extended to selected banks and mobile network operators, and may potentially include payment service providers and other niche technology providers. The SARB has stated categorically that the CBDC feasibility project is intended to be purely exploratory.
in nature; it does not constitute any long-term plan or commitment by the SARB to ultimately issue a CBDC as electronic legal tender. It is of course possible that the SARB may conclude from the feasibility study that it will not be issuing a CBDC.

**Distinguishing CBDC from other populist technologies**

In the Expression of Interest document, the SARB distinguishes between digital currency and virtual currency. It defines digital currency as a digital payment mechanism that is denominated in fiat currency, whilst a virtual currency is a digital representation of value, issued by private developers and denominated in its own unit of account. Virtual currency does not constitute legal tender in fiat currency or central bank money.

Cryptocurrency is viewed by the SARB as encompassing both digital and virtual currency, with the definitional aspect being that the currency (digital or virtual) relies on secure cryptographic algorithms for its creation and transactional operations. The SARB intends that CBDC will be a digital payment mechanism based on a cryptocurrency denominated in fiat currency, backed by the SARB to the same extent as cash in the context of legal tender.

The SARB wants the focus to be on the business objectives and functional attributes of CBDC, rather than the necessary technical platform. Accordingly, solution providers are not expected to use a specific technology platform, whether that is distributed ledger technology, blockchain or an existing “traditional” technology. Instead, the SARB envisages a solution that could be based on any one or a combination of technologies.

**Proposed principles and attributes of CBDC**

Whilst CBDC can be a universally accessible version of central bank reserve money, and a version of central bank issued commercial bank account money, the feasibility study is focusing only on CBDC as an electronic version of cash. In this regard, the SARB has proposed some of the following principles and attributes for CBDC (amongst others), which are subject to change based on the feasibility project:

- CBDC must be acceptable and useable at all levels of transactions.

**Policy**

- CBDC will be issued as legal tender either by the SARB or alternatively by commercial banks, under regulatory oversight of the SARB.
- CBDC supply must be limited in terms of the applicable monetary policy.
- CBDC must be complementary to cash, and not replace it. However, transacting with CBDC must be free to the consumer, or at a very low cost, one which is significantly below current payment channel fees. In this regard, CBDC may displace cash to some extent over time.
- Consumers must be able to own and transact in CBDC without the need for a bank account.

**Branding**

- CBDC must be branded, unique in its design, and its ownership by the SARB as issuer must be clear and evident.

**Transactional usage**

- CBDC must enable immediate person-to-person transfer of value without today’s clearing and settlement process.

From a public perspective, we will have to await the outcome of the feasibility project before we have more clarity on the SARB’s course of action. For proponents of a CBDC, the SARB’s current actions do appear to be promising.
General and non-functional
• CBDC transactions must be fast and efficient and allow consumers to transact using smart phones.
• It must be possible for CBDC tokens to be withdrawn from circulation and replaced with newly issued, more advanced tokens as technology upgrades and changes occur.

Are we there yet?
The response due date for the Expression of Interest has come and gone. Successful solution providers will be invited to respond to a request for a proposal for the CBDC feasibility project. The SARB expects that the solution providers will provide the necessary technology, architecture input and guidance, technical skills and the technology capacity to host and execute the selected use cases, whilst it will provide the majority of the input and expertise in terms of business principles, desired functionality, policy and legal matters.

From a public perspective, we will have to await the outcome of the feasibility project before we have more clarity on the SARB’s course of action. For proponents of a CBDC, the SARB’s current actions do appear to be promising.

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CONSIDERATIONS FOR FOREIGN LENDERS AND SOUTH AFRICAN BORROWERS

LISCHA GERSTLE

In addition to the need to consider the South African Exchange Control Regulations, 1961 in the context of cross-border loan transactions, further requirements in respect of both the borrower and lender in these transactions must typically be considered.

The National Credit Act, 2005
The granting of funding or credit to a South African borrower is governed by the National Credit Act (NCA). It is important to determine in each transaction whether a credit grantor is required to register as a “credit provider” under the NCA, as non-registration in a situation where this is required can have serious consequences for the credit provider. A lender who is required to be registered as a credit provider, but who is not, will not be able to enforce a loan agreement against a South African borrower as it will be void in terms of the NCA. The NCA applies to every credit agreement in South Africa that is entered into between parties dealing at arm’s length, or which has an effect within South Africa. This is the case regardless of whether the credit grantor (the lender) concerned has its principal business in or outside of South Africa.

There are a number of exemptions from the application of the NCA. Noteworthy in the present context is that the NCA does not apply to a credit agreement (facility agreement) extended to a South African juristic person where the net asset value or annual turnover of all persons related to that juristic person equals or is in excess of R1 million.

A juristic person is considered to be “related” to another juristic person if:

a) one of them has direct or indirect control over the whole or part of the business of the other; or

b) the same person has direct or indirect control over both of them.

Incidentally, the NCA will not apply to credit agreements (or facility agreements) extended to juristic persons whose net asset value or turnover falls below R1 million where the principal debt owing under that credit agreement or loan equals or exceeds R 250 000.

Typically, cross-border transactions that are implemented in the capital markets will fall outside the ambit of the NCA and within the exemption already described. Nonetheless, it is important to bear in mind the triggers for the application of the NCA in making this determination. The NCA enjoys general application to offshore lenders offering or extending loans and credit to South African residents, subject to the exemptions mentioned.
Financial assistance

Another consideration that a foreign lender must take cognisance of when advancing funding to a South African borrower is the requirement under the South Africa Companies Act, 2008 for the South African borrower to pass the requisite financial assistance resolutions. The Act makes a distinction between financial assistance for the subscription of securities and financial assistance in respect of the advancing of money, guaranteeing a loan or other obligation and securing any debt or obligation of a related or inter-related company or a director of the company or a related or inter-related company.

It is noteworthy that if the correct financial assistance resolutions are not passed in both instances, the financial assistance and the agreement in respect of which that assistance is provided are void, and cannot be retrospectively approved. The financial assistance resolutions will typically require the company granting the financial assistance to pass the solvency and liquidity tests pursuant to a board resolution, as well as a shareholder resolution approving the financial assistance.

Withholding tax

From a South African borrower’s perspective, leaving aside the exchange control approval required under the Regulations in order to obtain a loan from a foreign lender, it is necessary to consider the withholding tax and tax treaties with other countries that apply to the facility agreement being concluded with a foreign lender.

A new withholding tax on interest came into effect in South Africa on 1 March 2015. The withholding tax is applicable to interest received by non-residents (that is, the foreign lender) to the extent that the interest has been received or is accrued from a source within South Africa. It is imposed at a rate of 15%, subject to any reduction that might apply in respect of a double taxation agreement.

The Income Tax Act, 1962 (ITA) imposes a duty on the South African borrower to withhold the amount of withholding tax on any interest payable to the foreign lender. The ITA deems interest to be paid on the earlier of the dates on which the interest is paid or becomes due or payable.

There are a number of exemptions that apply to withholding tax on interest under the ITA. For example, interest paid by the South African government, a South African bank or in respect of any listed debt is not subject to withholding tax on interest.

Security structure

In syndicated loan transactions, providing security to a separate entity from the lenders obviates the need to re-create security every time the lenders change in the syndication. For a number of reasons, the English law security trust structure is not recognised or valid under South African law. Instead, the use of a special purpose vehicle (SPV) as security holder and guarantor of a syndicated facility is common when a South African borrower is involved.

This security structure requires:

a) an SPV and an owner trust to be established;
b) the SPV to provide a guarantee to the security agent acting on behalf of the lenders;
c) the borrower (and possibly other obligors) to indemnify the SPV for any payments made in relation to the enforcement of a claim under the guarantee issued to the security agent; and
d) the borrower (and other obligors, if any) to provide security for that indemnity.

The benefit of the SPV structure is that it creates a substantially similar result to the English law security trust structure where a separate entity holds the security and allows for trading in the syndicated loan (and related security) without affecting the security or requiring it to be re-created.

Each of the considerations touched on, in addition to the exchange control approval required under the Regulations, requires in-depth analysis in the context of cross-border transactions to ensure that the South African regulatory obligations of both the foreign lender and domestic borrower are adequately addressed. ●

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