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## NOTICE

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### FINANCIAL SERVICES BOARD

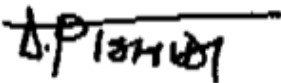
No. 5

20 December 2011

**PENSION FUNDS ACT, 1956: REGULATION 28 OF THE REGULATIONS  
MADE UNDER SECTION 36 OF THE ACT:  
CONDITIONS FOR SECURITIES LENDING TRANSACTIONS**

I, Dube Phineas Tshidi, Registrar of Pension Funds, hereby prescribe the conditions for securities lending transactions for pension funds as per Regulation 28(3) of the Regulations made under the Pension Funds Act, 1956 (No. 24 of 1956) as set out in the Schedule below.

Pension Funds are required to ensure that all securities lending transactions are in compliance with the requirements set out in this Board Notice by not later than 30 June 2012.



**DP TSHIDI**

**Registrar of Pension Funds**

# SCHEDULE

## SECURITIES LENDING TRANSACTIONS

### 1. Definitions

In this Schedule, “**Act**” means the Pension Funds Act, 1956 (Act No. 24 of 1956). Any word or expression to which a meaning has been assigned in the Act or Regulation 28 has that meaning and, unless the context otherwise indicates—

“**counterparty**” means the borrower to the securities lending transaction;

“**nominee**” means a nominee registered in terms of Board Notice 63 of 25 May 2007 – Requirements imposed by the Financial Services Board for Nominees to operate in South Africa, 2007;

“**securities lending transaction**” means any arrangement in terms of which—

- (a) a person (hereinafter referred to as the lender) lends a listed security to another person (hereinafter referred to as the borrower) in order to enable the borrower to effect delivery (other than to the lender in relation to the borrower, unless the borrower can demonstrate that the arrangement was not entered into for the purposes of the avoidance of tax) of that security within 10 business days after the date of transfer of that security from the lender to the borrower in terms of that arrangement;
- (b) that borrower is contractually required to compensate that lender for any distributions in respect of the listed security which that lender would have been entitled to receive during that period had the arrangement not been entered into; and
- (c) the arrangement does not affect the lender's benefits or risks arising from fluctuations in the market value of the listed security, but does not include an arrangement where the borrower has not—
  - (i) on-delivered the listed security within the period referred to in paragraph (a); or
  - (ii) returned the listed security contemplated in paragraph (a) to the lender within the period referred to in that paragraph;

### 2. Conditions

2.1 A fund may engage in a securities lending transaction, where such securities lending transaction is in compliance with the investment policy statement of the fund, the liquidity requirements of the fund and the principles as set out in regulation 28(2), subject to the following conditions:

- 2.1.1 the securities lending transactions must be undertaken in a safe and prudent manner and in accordance with the lending policies and procedures that are approved by the fund to provide additional income or fees for the benefit of the fund;
- 2.1.2 the fund must ensure that controls and procedures relating to such securities lending transactions are comprehensive and sound;

- 2.1.3 where the administration of a securities lending transaction is outsourced –
  - (a) the institution to which it is outsourced has the necessary experience and expertise to perform the required duties in a competent and responsible manner; and
  - (b) the administrative and reporting arrangements are clearly set out and agreed to in writing;
- 2.1.4 the fund must ensure that it transacts with a reputable and credit worthy counterparty and must perform a due diligence investigation of the counterparty taking into account at least the counterparty credit risk, credit rating, liquidity and volatility prior to entering into a securities lending transaction;
- 2.1.5 a fund may only utilise the following counterparties for purposes of any securities lending transaction:
  - (a) South African and foreign banks;
  - (b) A collective investment scheme as contemplated in the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002);
  - (c) A long-term insurer registered under the Long-term Insurance Act 1998, (act No. 52 of 1998);
  - (d) National Treasury;
  - (e) South African Reserve Bank; and
  - (f) The JSE Limited.
- 2.1.6 A fund may delegate any of its responsibilities to another person or entity but the board of the fund remains responsible for any such actions or decisions taken as a result of such delegation.
- 2.2 The board of the fund must, at least annually, review and approve its securities lending policy, specifically in respect of –
  - 2.2.1 the types of securities that may be subject to securities lending transactions;
  - 2.2.2 the overall and individual securities lending limits to securities lending transactions;
  - 2.2.3 the general credit worthiness criteria used in establishing its list of approved counterparties;
  - 2.2.4 the person/entity responsible for the monitoring of securities lending transactions;
  - 2.2.5 the quantity and quality of the collateral held against the borrowed securities and how collateral must be held;
  - 2.2.6 the method and person responsible for the collection of revenue from the securities lending transactions; and
  - 2.2.7 the reassessment to determine whether the relevant securities lending transactions are for the benefit of the fund taking into account the relevant risks associated thereto.
- 2.3 The board must continuously monitor and verify at appropriate intervals that –
  - 2.3.1 the fund has followed the internal procedures and standards established in determining the quality of a borrower;

- 2.3.2 the securities accepted as collateral are consistent with the approved securities lending policies of the fund;
- 2.3.3 the securities lent out do not exceed the maximum allowable limit as determined in paragraph 4 below; and
- 2.3.4 the collateral exists, the value placed on the collateral is reasonable and that the collateral held exceeds or is equal to the minimum collateral required.

### 3. **General requirements**

A fund may only engage in a securities lending transaction where –

- 3.1 securities involved in the security lending transaction consist of:
  - 3.1.1 listed equity;
  - 3.1.2 listed debt instruments;
  - 3.1.3 money market instruments issued by a bank; or
  - 3.1.4 listed assets which reference a listed underlying asset or assets.
- 3.2 adequate collateral is held at all times on behalf of the fund to protect itself against the risks associated with securities lending:
  - 3.2.1 in the name of the fund where the collateral is held in cash; and
  - 3.2.2 where the collateral is held in securities, securities must be held in the name of the fund, or where such securities are held on behalf of the fund must be clearly identified and tracked through a settlement authority.
- 3.3 the amount of collateral taken for securities lending transaction is in accordance with the guidance set out in paragraph 5 of this Notice;
- 3.4 the board ensures that the margin of collateral in excess of the fair value of the securities lent is appropriate at all times and provides adequate protection against volatility and liquidity concerns that may arise for securities lent and for securities held as collateral;
- 3.5 any securities lent are subject to an unqualified right of recall by the fund; and
- 3.6 the terms of recall provide that a fund may give notice subject to the standard settlement cycle for such securities on the relevant exchange or clearing organization through which the securities were originally delivered, to be returned.

#### 4. **Securities lending transaction limits**

The aggregate value of all equity, money market and debt instruments that are the subject of securities lending transactions may not at any time throughout the reporting period exceed:-

Description	Maximum % of fair value of security
Equities – Top 100 of companies (by market cap) listed on an exchange	75%
Other listed equities	50%
Debt – Government bonds	75%
Other listed debt instruments	50%
Money Market Instruments issued by a South African bank, including an Islamic liquidity management financial instrument	75%

Note: Where the fund has entered into a securities lending transaction and such listed equity delists during the reporting period, the fund must apply to the registrar for exemption in respect of the relevant transaction.

#### 5. **Collateral**

Collateral for the securities lent must be held for the benefit of the fund or its nominee on default, either via a valid pledge or by a nominee for the benefit of the fund, and at all times must comprise -

- 5.1 cash equal and/or bank issued money market instruments to at least 105% of the fair value of the total securities lent; or
- 5.2 debt instruments of which the fair value is equal to at least 110% of the fair value of the total securities lent; or
- 5.3 equities of which the fair value is equal to at least 115% of the fair value of the total securities lent; or
- 5.4 a combination of assets as per paragraphs 5.1 - 5.3 above, on condition that the limits set above will be applied in the same proportion as the total collateral held

#### 6. **Contractual requirements**

- 6.1 A securities lending transaction must be undertaken in terms of a legally binding written agreement with the borrower that complies with the definition or a "master agreement" as contemplated by section 35B of the Insolvency Act, 1936 (as amended).
- 6.2 The agreement(s) must set out the rights and obligations of all the parties to the agreement.
- 6.3 The agreement(s) must at least –
  - 6.3.1 identify the fund and either the outsourced agent or borrower;
  - 6.3.2 describe the securities that will form part of the securities lending transaction;

- 6.3.3 describe the type of acceptable collateral and required margin of collateral that will be provided and state if the collateral will be held on behalf of the fund via a valid pledge or held in nominee on behalf of the fund on default;
  - 6.3.4 in respect of any loan state that the agreement, together with any other securities lending agreement entered into between the parties, will constitute a single agreement;
  - 6.3.5 state that the fund will not remain entitled to the benefits (such as corporate actions, dividends or other income) associated with the lent securities, and such agreement should provide for payments or settlements to be made by the borrower to the fund in lieu of dividends or other income accrued or paid in respect of the securities that are the subject of the securities lending transaction; and
  - 6.3.6 state that where the borrower defaults or becomes insolvent, the fund's right of execution without a court order is reserved and should provide for the immediate transfer to the fund of the ownership and other rights, including voting rights, attached to the collateral.
- 6.4 The agreement(s) must set out the relevant conditions, parameters and processes (as applicable) in respect of -
- 6.4.1 where the aggregate value of the collateral exceeds or falls below the value of the securities lent;
  - 6.4.2 where the aggregate value of the collateral exceeds or falls below the agreed upon value of the collateral in relation to the value of the securities lent; and
  - 6.4.3 the fees or charges payable by the borrower and/or agent to the fund.

## **7. Disclosure of securities lending transactions**

- 7.1 Any securities that are subject to a securities lending transaction remain assets of the fund and must be disclosed in the annual financial statements of the fund as assets of the fund. The following information in respect of any securities lending transaction (both average securities lent throughout the financial period as well as at year end) must be disclosed in the notes to the financial statements of the fund –
- 7.1.1 a description and the fair value of the securities lent;
  - 7.1.2 the counterparty to the securities lending transaction; and
  - 7.1.3 the type and fair value of collateral and whether the collateral is held in the name of the fund or on behalf of the fund.
- 7.2 For purposes of the 25% counterparty limit as set in paragraph 3(h) of regulation 28, the counterparty exposure of the securities lending will not count towards such 25% limit.