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Revision of Board Notice 80 to the Collective Investment Schemes Control Act, 2002 (CISCA)

May 2014

Amendments to Board Notice 80 of 2012: Determination of securities, classes of securities, assets or classes of assets that may be included in a portfolio of a collective investment scheme in securities and the limits and conditions subject to which securities or assets may be included ('the Conditions').

Background

The revision of Board Notice 80 of 2012 aims to clarify and or remove certain inconsistencies; address industry abuses and allow for new developments, especially certain Financial Stability Board and National Treasury imperatives.

The following sections highlight the most important aspects of the amendments:

General revisions

1) New Chapter VI, which provides guidelines for due diligence investigations where foreign equity and non-equity securities are to be included in a portfolio.
2) Intention of the Registrar to issue an exemption notice for all managers to Subsection 45(a) (i) of CISCA that requires a currency sovereign rating equal to that of South Africa for the country of investment in non-equities. The result will be that only Subsection 45(a) (ii) applies, i.e. application of the due diligence guidelines for issuers determined by the Registrar.
3) A trust account has been removed from the definition of assets in liquid form.
4) Changes to Paragraph 24 of the Schedule confirms that an account in terms of Section 105 of CISCA can also operate as a portfolio account, but that the exposure created by such an account must then be added to other exposures of the same entity.

Revisions to Chapter 1: Standard Portfolio

1) A definition has been added for an 'investment company', as it is a term that is used throughout other chapters.
2) The reference to repurchase agreements has been deleted from the definition of 'securities', as repurchase agreements are not permitted securities.
3) Securities that are exchanged in terms of a repurchase agreement or are the securities subject to a repurchase agreement may be permissible, provided the following requirements in Paragraph 16 have been met:
   a. The portfolio may not suffer a loss as a result of the repurchase other than normal market movements;
   b. Any gains must be applied for the benefit of the portfolio; and
   c. A repurchase agreement should not be used unless the intention is to obtain a benefit for the portfolio in the first instance.
4) Clarified that the 120 percent limit, as applied to a security's weighting in an index, only applies to an equity type portfolio, so as to avoid ongoing abuse of the rule in multi- asset allocation type portfolios.
5) Clarified that a Standard Portfolio may only invest in a fund of funds if the fund of funds is 85% invested offshore and does not invest in another fund of funds or feeder fund.

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6) Provides references to the due diligence investigations required for foreign non-equity securities.

7) Previous inclusion of participatory interests in a collective investment scheme consisting of non-equity securities and assets in liquid form has been removed and replaced with the inclusion of assets in liquid form.

8) Provides for exposure limits for foreign non-equity securities as well as non-equity securities listed and traded on exchanges. The quality of listed non-equity securities is tempered by other appropriateness and due diligence conditions.

9) Conditions have been amended to extend investment in securities based on the value of gold to all the other SA precious metals. An overall portfolio exposure limit of 10% to all commodity referenced instruments has been determined. In addition the principle of excluding a collective investment scheme from holding any instrument for which the portfolio may be obliged to take physical delivery of the commodity has been included.

Revisions to Chapter 2: Money Market Portfolio

1) The term 'and Short-term Debt' has been removed from the naming of the chapter as it is too cumbersome and confusing in an international context. However, the definition of a 'money market portfolio' has been extended to include any portfolio structured as a short-term debt portfolio.

2) Reference to a constant price in the definition has been deleted as this is no longer a requirement. Money market portfolios are now encouraged to apply daily marking to market and provide a variable price.

3) Definition of an 'interest rate swap' is included as it is a transaction that is permitted for application to money market instruments existing in a portfolio.

4) A definition of a 'maturity date' has been inserted (i.e. the date at which capital must be repaid with all interest is applied, irrespective of so called 'reset dates' or 'roll-overs' and irrespective of it being subject to a notice from the manager to reset the instrument), to end ongoing interpretation issues and to clarify what the Regulator's intentions are pertaining to determinations of maturity dates.

5) The manner in which a transaction for the swap of interest rates may be applied to a money market instrument is determined in this chapter. It is further clarified that such swap may not be applied against the portfolio, but only on an instrument level and that it does not alter the maturity or create leverage within the portfolio.

6) Exemption for Islamic funds is again removed as a separate exemption notice has been issued.

7) Conditions inserted for inclusion of securitisation vehicles, also referred to as 'conduits', that are permitted and regulated under the Banks Act (e.g. they may not be synthetic, must be listed on an exchange, must provide sufficient disclosure to permit evaluation of all risks involved, etc.).

8) Conditions have been amended to clarify that a money market fund may apply a daily marked to

market variable price and where it does apply a constant price the portfolio must:

a. Be valued on a mark-to-market basis on the last day of the month;

b. On the last day of the month the described adjustments must be made to the actual yield;

c. Where the yield becomes negative, the constant price must be adjusted downwards and reported to the Registrar.

9) Condition inserted that requires the implementation and application of an ongoing risk management programme to ensure valuation and monitoring of the described risks relevant to money market portfolios.

10) Condition inserted that requires a constant 4% exposure by a money market portfolio to assets in liquid form.

Revisions to Chapter 3: Fund of Funds Portfolio

1) Conditions now recognise the need for fund of fund portfolios to utilise financial instruments to manage and hedge against exchange rate risks, subject to inclusion of such swaps being permitted by the supplemental deed applicable to the portfolio.

Revisions to Chapter 4: Feeder Fund Portfolio

1) Conditions now recognise the need for feeder fund portfolios to utilise financial instruments to manage and hedge against exchange rate risks, subject to inclusion of such swaps being permitted by the supplemental deed applicable to the portfolio.

2) Conditions confirm that a feeder fund cannot invest into a money market portfolio, as the money market portfolio investments are readily available and layering of costs in a low-income portfolio is not supported.

Revisions to Chapter 5: Financial Instruments

1) The definition of an 'asset portfolio' has been deleted as it is not used anywhere else in the Notice.

2) A section has been included to provide for the manner in which exposures created by non-equity securities may be netted with financial instruments based on certain non-equity securities.

Revisions to Chapter 6: General

1) Conditions clarify the position that the operational trust account, as determined under Section 105 of CISCA, must be considered when exposure/investment limits are being applied.

Exemption of the manager of a collective investment scheme in securities from certain provisions of BN 80 to CISCA

1) A manager who has included in a money market and short-term debt portfolio an instrument issued by a special purpose institution as determined in the Notice on Securitisation Schemes under the Banks Act, 1990, is not obliged to disinvest from, and may continue to hold such instrument, on condition that:

a. The securitised assets are permissible for investment in accordance with the Notice;

b. No synthetic securitisation schemes are included; and

c. The manager may not make any new investment in such instruments.

2) A manager who is not currently invested in an instrument as described above may not invest in such an instrument for the duration of this exemption.

Conclusion

The amendments of Board Notice 80 should clarify some uncertain interpretations and address issues surrounding new developments in the collective investment scheme environment.

Should you wish to discuss how we can help you, please call your regular contact or, alternatively:

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