

## **CONSULTATION PAPER**

### **PROPOSED CHANGES TO THE JSE DERIVATIVES MEMBERSHIP STRUCTURE**

1. The JSE is currently in the process of reviewing its derivatives and equities rules. This process will result in material amendments being made to the rules in phases over approximately the next 12 months. The objective of this consultation paper is to outline the principles underpinning proposed changes to the JSE Derivatives membership structure, as well as the rationale for and the anticipated timing of such proposed changes. It is our intention to draft the new rules within the framework as outlined in this consultation paper.

As stated in the Notice to members dated 8 April 2005, the JSE is currently drafting the necessary amendments to its rules in order to meet the requirements of the Securities Services Act, No. 36 of 2004 (“the SSA”), which became effective on 1 February 2005. The amendments to the rules to accommodate the SSA are the first phase of the rule amendments. The proposals contained in this consultation paper are over and above the SSA amendments.

Members are required to inform the JSE in writing, as prescribed in Appendix (E), of any comments that they may have on the proposed new structure, including their anticipated status under the new model either as members, trading participants and / or clearers, before 20 May 2005.

Members must note that whilst this initial feedback to the JSE is an important element of the consultation process, at this stage it is only indicative. Once the initial consultation process is complete, the appropriate new rules will be drafted. Once the new rules have been approved, members will be given a window period in which to formally notify the JSE of their status in terms of the new model or apply to the JSE for authorisation under a particular authorised user category where this is required in terms of the rules.

2. In order to address the flaws which exist in the current regulatory framework for derivative membership, the JSE is aiming to introduce a membership structure that will be more compatible with and which will more accurately reflect the realities of its current membership. This will ensure a more effective and efficient regulatory environment.
3. The current membership rules of the Derivatives division of the JSE reflect the principles as contained in the old Financial Markets Control Act, 1989 (“the FMCA”). This Act defined a “*member*” as “...*in relation to a financial exchange, means any person who is a Financial Instrument Trader or a Financial Instrument Principal*”.

The key difference between these two types of members is that a Financial Instrument Trader is authorised to trade on behalf of other persons or on his own account, whereas a Financial Instrument Principal is restricted to trading on his own account.

The above principle is reflected in the current Derivative rules which provide for a membership structure that distinguishes primarily between the membership classes of clearing and non-clearing and between the categories of broking and non-broking as follows: -

**CURRENT DERIVATIVES MEMBERSHIP STRUCTURE:**

<b><u>Member Category</u></b>	<b><u>Member Class</u></b>	
	<b>Clearing</b>	<b>Non-Clearing</b>
<b>Broking</b>	Clearing Broking	Non-Clearing Broking
<b>Non-Broking</b>	Clearing Non-Broking	Non-Clearing Non-Broking

4. The current membership of the Derivatives division includes a broad range of diverse commercial enterprises that include:-
- Banks regulated by the Registrar of Banks;
  - Financial Services Providers (FSPs) regulated by the Financial Services Board in terms of the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act);
  - Diversified agricultural commodity trading houses;
  - Proprietary trading entities (including inter-dealer brokers);
  - Agency brokerages trading on behalf of clients;
  - Entities whose primary activity involves trading securities on financial exchanges other than the JSE; and
  - Entities engaged to varying degrees in a combination of the above activities.
5. In terms of the SSA, the JSE has to supervise compliance by its members with rules which include (a) capital adequacy, (b) segregation and custody of client assets, (c) the execution of transactions, and (d) advice and the management of securities.

As can be seen from the composition of the existing membership, monitoring and enforcing compliance with all these rules consistently across all types of members is either:

- (i) not possible in the case of banks and FSPs where these entities are lead regulated by other regulators and where the clients of such entities may

have relationships with such entities which extend beyond JSE listed or JSE regulated products; or

- (ii) not necessary in respect of proprietary trading firms that do not trade for clients or manage securities and which therefore have a lower regulatory risk profile; or
  - (iii) impractical in the case of diversified commercial enterprises involved in activities beyond financial markets and where accurate measurement of the member's capital adequacy is difficult to achieve due to the scope of the member's activities.
6. The SSA provides the overriding statutory legislation for "securities services" that are defined as "...services provided in terms of this Act in respect of—
- (a) *the buying and selling of securities;*
  - (b) *the custody and administration of securities;*
  - (c) *the management of securities by an authorised user;*
  - (d) *the clearing of transactions in listed securities; and*
  - (e) *the settlement of transactions in listed securities;"*

The SSA replaces the Stock Exchanges Control Act, 1985, the Financial Markets Control Act, 1989, the Insider Trading Act, 1998 and the Custody and Administration of Securities Act, 1992. The SSA also replaces the FMCA concept of "member" with the term "authorised user".

Authorised user is defined as "... a person authorised by an exchange in terms of the exchange rules to perform such securities services as the exchange rules may permit". This new concept also recognises the diversity of specialist entities involved in the activities of regulated markets.

It is imperative that the JSE's proposed derivatives membership structure complies with the framework of the SSA and at the same time is compatible with and reflects the diverse nature of persons authorised to use its services. The new membership structure must provide a robust framework that recognise these realities, whilst enabling the JSE to effectively regulate the activities of its users and protect clients and market participants where it needs to.

In defining a proposed new structure, the JSE has taken particular cognisance of:-

- the role of other regulators & related legislation:
  - SARB Banking Supervision & the Banks Act;
  - The Financial Services Board and the FAIS Act;
  - Foreign regulators;
- the membership structures in other comparable markets;
- the role of clearers in providing clearing services, including member default arrangements;

- the lower regulatory risk profile of proprietary traders and inter-dealer brokers; and
  - the diverse commercial activities undertaken by certain members, where their derivatives activities on the JSE comprise only a small part of their overall operations.
7. The structure proposed by the JSE provides for authorised users of the JSE derivatives markets to be defined in terms of three broad categories: -

**NEW FRAMEWORK FOR AUTHORISED USERS :**

<b>Authorised Users</b>		
Derivative Members	Trading Participants	Derivative Clearers

- The primary difference between members and trading participants is that members will be regulated by the JSE with respect to all of the core elements of investor protection, namely, capital adequacy, safeguarding of client assets, best execution of transactions and advice and management of securities, and shall have as their dominant activity the trading in securities, as defined in the SSA, on one or more licensed exchanges in the Republic; whereas trading participants will primarily only be regulated by the JSE in respect of their use of the JSE trading systems, due to the scope of their activities.
8. The reasons for requiring a “member” in the new structure to conduct its activities predominantly as an exchange member are: -
- (a) to ensure that the JSE does not assume regulatory responsibility for a firm whose business activities are mainly unrelated to exchange business; and
  - (b) to enable the JSE to effectively regulate those activities of a member which impact on the member’s clients, as the JSE’s ability to conduct effective regulation would be significantly compromised if the majority of a member’s business activities were unrelated to exchange business.
9. Splitting the existing non-clearing members into the two groups of “members” and “trading participants” achieves the following: -
- (a) it recognises the current reality that the client related activities of some derivative members are regulated by the JSE, whilst the client activities of other derivative members are regulated by other regulators, such as the Reserve Bank and the FSB in terms of other legislation;
  - (b) it identifies for the benefit of clients of authorised users whether the activities of the authorised user which impact on those clients are regulated by the JSE or by another regulator;

- (c) it enables the JSE to limit the applicability of its rules to those activities performed by an authorised user which need to be regulated by the JSE. For example, the rules which will apply to a trading participant will generally only be those that relate to the use of the JSE trading systems and the clearing of transactions through the clearing house;
  - (d) it enables the JSE to require that authorised users who act on behalf of clients, where such activity is regulated by the JSE, conduct their business predominantly on exchanges as members, to achieve the objectives set out in paragraph 8 above; and
  - (e) it limits the access to the JSE compensation schemes, such as the Fidelity Fund, to clients of defaulting “members” who have suffered a loss which is covered by the scheme, on the basis that the JSE can only offer this type of protection if it is responsible for regulating the client related activities of the authorised user, which is not the case with trading participants.
10. In terms of this new structure, authorised users who are classified as members and who are in any way involved in the custody or administration of their clients’ funds shall be required to apply to the JSE in the prescribed format and demonstrate that: -
- (a) they have the necessary operational infrastructure, information technology systems, internal controls, management review processes, people, resources and expertise in order to have custody over their clients’ funds; OR
  - (b) they have entered into an acceptable outsourcing arrangement with a custody agent for the outsourcing of the key elements of their custody function. For the purposes of this requirement, the “custody agent” shall be the member’s clearer and such clearer shall also be an authorised bank.
11. Trading participants will include organisations such as banks, financial services providers, proprietary-only and inter-dealer trading entities. Customers of trading participants shall be protected in terms of the regulatory protections afforded by the respective lead regulators of such trading participants.
- If a trading participant is not regulated by another regulator in respect of its client activities it will not be permitted to act on behalf of clients in the JSE derivative markets, as the JSE would not be regulating such activities and a firm cannot act on behalf of clients without some form of regulatory supervision. The JSE regulation of trading participants shall largely be limited to their use of the JSE trading systems only.
12. In respect of clearing members, provision has been made for the introduction of clearers who may not necessarily be authorised to trade on the exchange as derivative members or trading participants. In such instances, the clearer shall be

required to have binding contractual arrangements in place with an appropriate authorised user in order to discharge its obligations in terms of the rules and its contractual arrangements to the clearing house, the JSE and to authorised users and clients in the event of default by any party for whom it clears.

13. The capital requirements for clearing members, particularly the smaller clearing members, will also be amended to more appropriately reflect the clearing risk assumed by them. Capital requirements for smaller clearing members will take into account and be linked closely to the initial margins for which they are responsible and which are held through the clearing house, together with certain additional concentration risk requirements.
14. In the attached appendices (A) to (C) we have summarised the key principles upon which the above structure is based.
15. In addition to these new principles, the JSE has also considered its intended approach to defaults within this new authorised user framework. Of particular importance are the principles outlined in Appendix (D).
16. **ISSUES TO BE CONSIDERED BY ALL CURRENT MEMBERS: -**

It is imperative that existing members carefully analyse and understand the proposed framework in order to establish their anticipated status under the new membership model. Existing members that wish to be authorised as derivative members under the proposed new framework AND that are in any way involved in the custody or administration of their clients' funds will in future be required to apply to the JSE if they wish to perform that function themselves as members, as described in item 9 of Appendix (A).

Current members will need to consider and decide on their intended corporate structure going forward in terms of their status as authorised users and will need to consider factors such as: -

- (a) The lower capital requirements for dedicated proprietary trading or inter-dealer entities that have no Safex clients (i.e. the JSE will only require such entities to maintain a positive net asset value, similar to that prescribed in the FAIS Act for FSPs).
- (b) The absence of any "position risk requirement" on the proprietary positions of own account trading firms approved as trading participants.
- (c) Their primary focus as authorised users.
  - (c.1) Where trading on regulated exchanges in the Republic is the firm's dominant activity in relation to their overall operations

and where the firm also engages clients on the exchange, such firm is likely to require membership status of the JSE.

- (c.2) Where exchange traded activity as an authorised user is small relative to the firm's overall operations or where the firm is lead regulated by another regulator, they are likely to require trading participant status.
- (d) Agricultural commodity trading houses will need to consider their primary purpose for trading on the exchange (i.e. Is Safex trading for clients and / or their own account core to their primary activities or is Safex trading relatively small in comparison to their overall operations as an entity?).

Entities that will not qualify as members due to the marginal (non-core) nature of their Safex activities, will need to consider forming separately capitalised legal entities should they wish to continue engaging clients on Safex and remain authorised as derivative members in respect of those client activities.

- (e) Current derivative members include financial services providers who have been operating under the exemption for members in terms of Section 45 of the Financial Advisory and Intermediary Services Act, 2002. Where such entities conduct transactions on behalf of clients and such transactions are conducted through other exchange members or are not conducted on the exchange, to the extent that the dominance of such non-member activities disqualifies them from derivative membership, they will need to obtain an FSP licence in terms of the FAIS Act before applying to be authorised as derivative trading participants.
- (f) The possibility of having more than one authorised user within the group operating on the exchange (i.e. a proprietary trading derivative trading participant and a derivative member trading on behalf of clients). Authorised users must ensure that in acting in the best interests of their clients, their conduct is not unduly influenced by the activity of an associated entity.
- (g) The costs associated with forming a separately capitalised legal entity, including taxation factors, etc.

Members are urged to contact Richard Bone on (011-520 7150) or [richardbone@jse.co.za](mailto:richardbone@jse.co.za) should they wish to discuss their profile or anticipated status in light of this consultation paper.

## APPENDIX (A)

<b>PROPOSED PRINCIPLES APPLICABLE TO DERIVATIVE MEMBERS</b>	
1	A derivative member shall be a corporate body, incorporated and registered as a domestic company under the Companies Act, 1973.
2	A derivative member shall have its primary place of business and conduct its main operations within the Republic.
3	<p>A derivative member must have as its dominant activity the trading in securities on one or more licensed exchanges in the Republic and the management of investments in such listed securities, as an authorised user of such exchanges. In order for the JSE to compare a member's exchange related activities to its other areas of business activity the following factors will be considered:</p> <ul style="list-style-type: none"> <li>- The revenues and profits earned or generated by the member in all of its areas of business activity;</li> <li>- The value of transactions in the respective areas of business activity;</li> <li>- The value of client assets managed by the member in the respective areas of business activity;</li> <li>- Any other factors which are deemed by the JSE to be relevant to such determination.</li> </ul>
4	<p>As a result of the introduction of the FAIS Act and to minimise the adverse consequences of dual regulation of members by the JSE and the Financial Services Board, the JSE has extended the scope of its regulation of member firms' activities beyond instruments listed on the JSE to incorporate certain "other investments" including securities listed on foreign exchanges and participatory interests in collective investment schemes as defined in the Collective Investment Schemes Control Act, 2002.</p> <p>A derivative member shall be regulated by the JSE in respect of its activities involving the management of such "other investments" where its dominant activity comprises the trading in securities on the JSE as a member of the JSE, including the management of investments in such JSE listed securities.</p> <p>Where a member fails to meet the above criteria for the JSE regulation of "other investments", the member shall be required to obtain an FSP licence from the FSB in terms of the FAIS Act for the conduct of such activities.</p>
5	A derivative member that is not authorised to clear shall be required to enter into a clearing agreement with a derivative clearer.
6	The JSE shall apply full capital adequacy to members and each member shall at all times be required to hold adjusted liquid capital sufficient to meet its Base requirement and its Risk requirements (i.e. position, counterparty and large exposure risks) as specified in the rules.

7	The JSE shall be entitled to terminate the membership of a derivative member should there be a deficiency in the capital adequacy requirement of the derivative member as prescribed in the derivative rules and directives, where such a deficiency cannot be immediately rectified.
8	<p>The proposed membership requirements will provide for a possible lead regulation of members by other exchanges in the Republic that are self-regulatory organisations (e.g. The Bond Exchange of SA).</p> <p>Such lead regulation would typically occur where the majority of the exchange related activities of a derivatives member takes place on the other exchange.</p> <p>In such instances, the JSE will still regulate compliance with the JSE trading rules and the protection of the client assets which are related to JSE activity e.g. Safex margins.</p>
9	<p>Each member that is any way involved in the custody or administration of its clients' funds will be required to apply to the JSE and demonstrate that: -</p> <p>(a) it has the necessary operational infrastructure, information technology systems, internal controls, management review processes, people, resources and expertise in order to have custody over its clients' funds; OR</p> <p>(b) it has entered into an acceptable outsourcing arrangement with a custody agent for the outsourcing of the key elements of its custody function.</p> <p>The outsourcing option prescribed above will not absolve members from the responsibilities associated with having custody over their clients' funds.</p>
10	The custody agent referred to in item 9 (b) above shall be the member's clearer, who shall be a bank.
11	A derivative member may also be authorised by the JSE as a derivative clearer.
12	Clients of a member will no longer be registered directly with the JSE as "Safex clients" and it will be made clear in the rules that clients are the clients of the member rather than being "Safex clients". A member will merely open client accounts on the clearing system for clearing purposes by submitting relevant client details to the JSE. Clients of a member will still receive the protections afforded in terms of (a) the JSE fidelity fund (b) the JSE rules on the custody and segregation of client assets and (c) the JSE rules regarding advice and the management of securities.

## APPENDIX (B)

<b>PROPOSED PRINCIPLES APPLICABLE TO DERIVATIVE TRADING PARTICIPANTS</b>	
1	A trading participant may be a corporate body, a close corporation, a natural person or a partnership of natural persons.
2	Trading participants may also be authorised to clear.
3	A trading participant that is not authorised by the JSE as a clearer shall be required to enter into a clearing agreement with a derivative clearer.
4	<p>Trading participants shall be classified in terms of one of the following sub categories: -</p> <ul style="list-style-type: none"> <li>- A bank regulated by the Registrar of Banks;</li> <li>- A financial services provider lead regulated by the FSB;</li> <li>- An RSA domiciled person dealing in securities for his own account only;</li> <li>- A domestic RSA company operating mainly from offshore or an “External Company” as defined in the Companies Act, trading on the JSE for its own account, or trading on behalf of a fellow group company that is regulated by a foreign regulator;</li> <li>- A foreign registered and incorporated company dealing in securities for its own account or on behalf of offshore clients only and where such company is regulated by an acceptable foreign regulator. Authorisation in this sub-category shall require the existence of an acceptable memorandum of understanding between the Financial Services Board and an appropriate foreign regulator to ensure that jurisdiction exists in the area of Trading i.e. for Insider Trading / Market Abuse (e.g. an IOSCO member regulator).</li> </ul>
5	Trading participants will be permitted to open any number of accounts on the clearing system for clearing purposes, through their respective clearing members, but the existence of such an account will not afford the account holder any particular status with the JSE from a regulatory point of view.
6	<p>The regulatory protections afforded in terms of (a) the JSE fidelity fund (b) the JSE rules on the custody and segregation of client assets and (c) the JSE rules regarding advice and the management of securities etc shall not apply to “clients” of trading participants.</p> <p>Customers of trading participants must look to the regulatory protections afforded by the respective lead regulators of such firms under their legislation.</p> <p>JSE regulation of trading participants shall primarily be limited to their use of the trading system.</p>
7	Capital Adequacy for Trading Participants: -

	<ul style="list-style-type: none"><li>- Banks, FSPs and foreign trading participants will be required to comply with the capital adequacy requirements as imposed by their respective lead regulators, with an exemption for such entities from submitting capital adequacy returns to the JSE;</li><li>- Own account traders (including inter-dealer brokers) and domestic companies operating from abroad, shall be required to have assets that exceed the value of their liabilities at all times. In addition, the JSE shall reserve the right to request detailed management accounts at any time for any date from such trading participants.<ul style="list-style-type: none"><li>- For corporates, the JSE shall require the annual submission of signed and audited annual financial statements;</li><li>- For partnerships and sole proprietors, the JSE shall require an annual balance sheet signed by 2 partners or the sole proprietor;</li><li>- For the purposes of determining net asset value, the value of assets shall exclude goodwill and other intangible assets, whilst the value of liabilities shall exclude the value of loans validly subordinated in favour of all other creditors.</li></ul></li></ul>

## APPENDIX (C)

<b>PROPOSED PRINCIPLES APPLICABLE TO DERIVATIVE CLEARERS</b>	
1	<p>A derivative clearer shall be required to be a corporate body registered and incorporated in the Republic, except where an “External Company”, as defined in the Companies Act, operates as a branch by means of which a foreign institution conducts the business of a bank and which is regulated in terms of the Banks Act 1990.</p> <p>Clearers shall be required to be both operationally and physically present in the Republic.</p>
2	<p>Clearers shall be required to have and maintain documented default contingency arrangements in the event of default by a member for whom they clear, to ensure:-</p> <ul style="list-style-type: none"> <li>- Continuity of business for underlying clients in terms of the rules;</li> <li>- Expertise &amp; skill of staff to service clients’ needs;</li> <li>- Segregation and protection of client assets.</li> </ul>
3	<p>Where a clearer is not a trading participant of the JSE that is a bank or a licensed FSP, or is not a derivative member, the clearer shall be required to have binding contractual arrangements in place with an appropriate authorised user in order to discharge its obligations to clients, other authorised users, the clients of such authorised users, the clearing house and the JSE in terms of the JSE rules and its contractual arrangements with such parties, where applicable.</p>
4	<p>Each clearer shall be required to have and maintain:-</p> <ul style="list-style-type: none"> <li>- Documented systems, resources, procedures &amp; expertise to enable it to clear and fulfill all of its obligations and to communicate with the clearing house;</li> <li>- Documented systems, resources and expertise to enable it to accurately and efficiently manage, measure and control the risks and related exposures to authorised users and to the clearing house arising out of its clearing agreements with such authorised users and the clearing house;</li> <li>- Documented internal policies and procedures that must include Chinese Walls and data sensitivity controls regarding the information pertaining to authorised users that clear through it.</li> </ul>

5	<p>All clearers shall be required to comply with prescribed minimum capital adequacy requirements at all times. Clearers will be required to qualify either in terms of: -</p> <ul style="list-style-type: none"> <li>(a) a broad high value minimum “shareholders equity” (i.e. share capital and reserves) requirement of R1Billion; or</li> <li>(b) an “adjusted net capital” requirement which must exceed specific risk factors as specified below and which shall be linked closely to the overall initial margin (“value at risk”) attributable to the clearer in terms of its role as a clearer, being held through the clearing house.</li> </ul>
6	<p>Adjusted net capital or qualifying capital for clearers with shareholders’ equity less than R 1 Billion shall be calculated as permanent capital plus additional capital less disallowable items (i.e. adjusted for certain disallowable assets) as follows:</p> <ul style="list-style-type: none"> <li>- permanent capital (fully paid ords, prefs &amp; share premium); plus</li> <li>- additional capital (distributable reserves, subordinated loans &amp; guarantees acceptable to JSE); minus</li> <li>- disallowable items (fixed assets – buildings; goodwill, investments in other group companies).</li> </ul> <p>This adjusted net capital as defined above shall exceed the higher of: -</p> <ul style="list-style-type: none"> <li>- R200 million; or</li> <li>- 10% of the non cash liquid assets of the clearer; or</li> <li>- 10% of the initial margin held by the clearer with the clearing house subject to a concentration risk factor (i.e. where more than 25% of such margin is attributable to or under the control or influence of one client or member, the clearer shall be required to apply a factor of 100% to such margins for the purposes of this section). The remaining margin shall attract a risk weighting of 10%.</li> </ul>
7	<p>Reporting requirements for clearers to the JSE shall be as follows: -</p> <ul style="list-style-type: none"> <li>(a) All clearers shall be required to submit copies of signed annual financial statements to the JSE within 3 months of the year-end;</li> <li>(b) Clearers with Shareholders Equity &lt; R1Billion shall be required to include their capital calculation at year end signed by 2 directors (i.e. adjusted net capital vs risk requirements as detailed above);</li> <li>(c) The JSE shall reserve the right to request copies of all regulatory submissions or detailed management accounts at any time, for any date;</li> <li>(d) As part of its risk based approach to such regulation, the JSE shall set appropriate margins by which a clearer’s Adjusted Net Capital or Shareholders’ Equity must exceed</li> </ul>

	<p>its minimum capital requirements, as stated above. Where a clearer's surplus capital falls below these benchmarks, the clearer shall be required to report the shortfall to the JSE immediately and submit returns more frequently until the amount of surplus capital exceeds the specified margin.</p>
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## APPENDIX (D)

<b>PROPOSED PRINCIPLES APPLICABLE TO DERIVATIVE DEFAULTS</b>	
1	<p>The rules shall outline the broad obligations for settlement and payment procedures in the JSE derivatives market in respect of margins, accrued interest and expenses, as detailed below, between clients, derivative members, trading participants, clearers and the clearing house, in terms of the clearing structure. These items include: -</p> <ul style="list-style-type: none"> <li>- Initial margins</li> <li>- Variation margins</li> <li>- Additional margins</li> <li>- Retained margins</li> <li>- Interest</li> <li>- Trading, clearing &amp; settlement fees</li> <li>- Physical deliveries</li> </ul>
2	<p>Whilst the rules shall also describe broadly the acts that will constitute default by an authorised user and its clients, in keeping with the principles outlined in this proposal and the difference in the status of derivative members and trading participants, the JSE does not propose to regulate the consequences of default in respect of default by trading participants or clients of authorised users.</p> <p>It is intended that the consequences of default by such parties shall be managed primarily in terms of the contractual arrangements between the relevant parties (i.e. as between clearer and trading participant, between trading participant and client; and between derivative member and client).</p>
3	<p>The rules shall also provide for and enable authorised users (i.e derivative members, trading participants, clearers) and the clearing house to use the protective mechanisms of the clearing structure and thereby set off obligations payable by a defaulting party per item 1 above against any margins or security obtained from such defaulting party.</p>

4	<p>Defaults by clients of derivative members: -</p> <ul style="list-style-type: none"> <li>- Although the act of default by a client will be broadly defined in the rules, the consequences of default for a client shall not be prescribed or regulated by the JSE, but shall be managed between the client and the member in terms of the contractual arrangements between these two parties;</li> <li>- the client may, depending on the contractual arrangements between the member and the client, be suspended from trading (i.e. there will be no regulatory obligation to suspend a defaulting client);</li> <li>- the member may, but shall not be obliged to, close out the positions of the defaulting client by - <ul style="list-style-type: none"> <li>(a) closing out these client positions by trading on the JSE derivatives trading system with 3<sup>rd</sup> party authorised users; or</li> <li>(b) closing out these client positions by transferring these directly to itself and for its own account, as principal, by booking these over through the JSE derivatives trading system;</li> </ul> </li> <li>- although the JSE may provide guidelines or parameters, it shall not approve the price at which a defaulting client's positions may be closed out in the market or the price at which they may be transferred to the member;</li> <li>- the close out of such positions shall be on the basis that the member deems appropriate, subject to any agreement that the member may have with the client in this regard;</li> </ul>

5	<p>Default by derivative members: -</p> <ul style="list-style-type: none"> <li>- the JSE shall regulate the consequences of default by a derivative member;</li> <li>- the derivative member shall be suspended from trading;</li> <li>- the JSE shall adopt the key principle in the existing rules whereby all client positions registered under a defaulting derivative member must be transferred either - <ul style="list-style-type: none"> <li>(a) to the clearer in its capacity as an authorised user that is a bank or licensed FSP or a derivative member; or</li> <li>(b) to another appropriate authorised user under instruction from such clearer;</li> </ul> </li> <li>- the JSE shall oversee the transfer of client funds not held by the clearer at the date of default to the clearer or to its duly appointed agent, or to the client;</li> <li>- although the JSE may provide guidelines or parameters, it shall not approve the price at which a defaulting member's own positions may be closed out in the market or the price at which they may be transferred to the clearing member;</li> <li>- in respect of the open proprietary derivative contracts of the defaulting derivative member, the clearing member shall – <ul style="list-style-type: none"> <li>(c) close these positions out by trading on the JSE derivatives trading system with 3<sup>rd</sup> party authorised users; or</li> <li>(d) close these positions out by transferring these positions directly to itself and for its own account, as principal, by booking these over through the JSE derivatives trading system;</li> </ul> </li> </ul>

6	<p>Defaults by clients of trading participants: -</p> <ul style="list-style-type: none"> <li>- although the act of default by a client of a trading participant will be broadly defined in the rules, the consequences of default in respect of JSE derivative contracts by a client will be managed in terms of the contractual arrangements between the trading participant and its client;</li> <li>- a trading participant may, but is not obliged to, suspend a defaulting client from trading;</li> <li>- although the JSE may provide guidelines or parameters, it shall not approve the price at which defaulting client positions are closed out in the market or the price at which these are booked over or transferred from the client's account to the trading participant's own account ;</li> <li>- a trading participant may, but shall not be obliged to - <ul style="list-style-type: none"> <li>(a) close out the contracts attributable to a defaulting client by trading on the JSE derivatives trading system with 3<sup>rd</sup> party authorised users ; or</li> <li>(b) close out such contracts attributable to a defaulting client by transferring such contracts to the trading participant itself, as principal, and by booking over these contracts through the JSE derivatives trading system;</li> </ul> </li> </ul>
7	<p>Defaults by trading participants: -</p> <ul style="list-style-type: none"> <li>- although the act of default by a trading participant will be broadly defined in the rules, the consequences of default in respect of derivative contracts of a trading participant will be managed in terms of the contractual arrangements between the trading participant and its clearer;</li> <li>- a clearer may, but shall not be obliged to, suspend a defaulting trading participant from trading;</li> <li>- although the JSE may provide guidelines or parameters, it shall not approve the price at which defaulting positions are closed out in the market or the price at which these are booked over or transferred from the trading participant's own account to the clearer;</li> <li>- a clearing member may, but is not obliged to - <ul style="list-style-type: none"> <li>(a) close out the contracts attributable to a defaulting trading participant by trading on the JSE derivatives trading system with 3<sup>rd</sup> party authorised users ; or</li> <li>(b) transfer such contracts attributable to a defaulting trading participant to itself, as principal, by booking over these contracts through the JSE derivatives trading system;</li> </ul> </li> </ul>
8	<p>It is proposed that the default of a clearing member shall be treated in the same manner as per the existing JSE Derivatives rules.</p>

**APPENDIX (E)**

**[For completion and submission to the JSE]**

Member Name: .....

Member JSE Short Code: .....

**Section I :**

Indicate anticipated status according to new authorised user categories per consultation paper:

<b><u>Authorised User Category</u></b>	<b><u>Sub-Category (where applicable)</u></b>	<b><u>Indicate</u></b> √
Derivative Member	Own custody of client funds	
	Outsourced custody of client funds to clearing member	
	No custody of client funds (i.e. execution only or “give up” arrangements)	
Trading Participant	Authorised Bank	
	Licensed FSP	
	Proprietary trading or inter-dealer only	
	Foreign registered and incorporated entities	
	Domestic RSA company operating mainly from overseas	
Clearing Member		

**Section II :**

Provide any comments that you may have on the proposed new structure, particularly in relation to its potential impact on your firm: -

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**Section III :**

Completed forms can be emailed or faxed to Eustacia Madumo at [eustaciam@jse.co.za](mailto:eustaciam@jse.co.za) or 011 – 520 8582 (fax). Members are also urged to contact Richard Bone on 011-520 7150 or [richardbone@jse.co.za](mailto:richardbone@jse.co.za) should they wish to discuss their profile or anticipated status in light of this consultation paper.

**Section IV :**

Full name and signature of compliance officer :-

Compliance Officer Name:.....

Signature:.....

Date:.....

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