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Financial Matters Amendment Bill with amendments to the Insolvency Act published – financial market participants have until just 8 February to comment

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On 1 February 2019, the South African Minister of Finance published the Financial Matters Amendment Bill (the "**Bill**") containing a long-awaited amendment to section 83 of the Insolvency Act, 1936. We previously discussed the purpose of the amendment to the Insolvency Act, as well as a number of issues associated with the first draft of the Bill (the "**Draft Bill**"), which was published on 24 August 2018.

As derivative market participants will be aware, amendments to the Insolvency Act are required before the Prudential Authority of the South African Reserve Bank (the "**Authority**") and the Financial Sector Conduct Authority the ("**FSCA**") can finalise the Joint Standard on Margin Requirements [for OTC derivatives], the last draft of which was published in August 2018. The proposed amendment to the Insolvency Act will affect all counterparties to agreements defined as "master agreements" under section 35B of the Insolvency Act (principally ISDA Master Agreements, Global Master Securities Lending Agreements and Global Master Repurchase Agreements, collectively "**master agreements**") in the event of an insolvency of a South African counterparty.

The Draft Bill previously included a limited recourse provision that would have prohibited a creditor from claiming (as an unsecured creditor) for any residual unsecured claim following the application of set-off under section 35B of the Insolvency Act and the realisation of any collateral security. Seemingly in response to resistance from market participants, the limited recourse provision has been removed from the Bill.

Unfortunately, the remaining amendments to the Insolvency Act seem to follow usual insolvency procedure, without taking much cognisance of the complex nature of global (and South Africa's) derivative, securities lending and repo markets.
The aim of the amendment to the Insolvency Act is to allow for a creditor's immediate realisation of collateral security that has been pledged by a debtor under a master agreement as required by the Margin Requirements. The Bill proposes the insertion of a new section 83(10A) and 83(10B) into the Insolvency Act.

Section 83(10A) will allow a creditor to retain proceeds it realises from the pledged security of a debtor in respect of claims under master agreements, provided that, *inter alia*, notice of the realisation is given to the Master and the Master notifies all creditors of the realisation and of their right to lodge an objection.

Section 83(10B) then allows any creditor to dispute the realisation of the security. The creditor may then object to the dispute and submit a response to the Master. If thereafter the Master finds the dispute to be well founded, the creditor must pay the proceeds (plus accruing interest) to the Master and may thereafter apply to the court to set aside the Master's decision.

It was hoped that the amendment to section 83 of the Insolvency Act would allow a timely procedure for a secured creditor to realise its pledged security and then pay over any excess to the Master, or claim for any shortfall as an unsecured creditor and finally close off its position to avoid any ongoing market or other risk. This would make the receipt of pledged collateral (as will be required by the Margin Requirements in respect of "initial margin") as attractive for the secured party as the receipt of collateral transferred outright (which collateral can simply be included in the close out netting calculation, with no enforcement required). Instead, a creditor holding pledged collateral must wait until 14 days after the second meeting of creditors (which in turn may be months after the initial insolvency commencement) before the creditor can close off the position and move on, or know whether it will remain mired in a contractual dispute resolution process with other creditors of the insolvent.

The new dispute resolution process is likely to turn market participants back to using outright transfers of collateral, where possible under regulatory conditions. Will the international industry associations that source "netting opinions" (on the basis of which international institutions trade derivatives, securities loans and repos with South African counterparties and financial institutions are able to minimise capital holding requirements) give South Africa's post insolvency close-out netting regime on pledged collateral a clean bill of health, notwithstanding these potential delays and processes? Probably not as drafted.

Finally, it is unclear whether realised collateral security that may still be subject to dispute can truly be said to be **immediately available** as specified by the Margin Requirements. The amendment of the Insolvency Act is an opportunity to modernise the treatment pledges of collateral for financial market purposes, but with this Bill it is not clear whether the amendments will enable pledges of collateral security to satisfy the Authority's and the FSCA's conditions set out in the Margin Requirements.

Although numerous negative comments were submitted in response to the Draft Bill regarding the introduction of the dispute resolution process, the process has remained in the published Bill. Market participants have been given only a few days to digest the amendments, and can submit comments to the Bill by emailing Ms Teboho Sepanya at tsepanya@parliament.gov.za by no later than **12:00 on Friday, 8 February 2019**.

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