

***THE ROLE OF THE JSE IN THE GLOBALIZATION PROCESS
WITH SPECIFIC EMPHASIS ON THE IMPLEMENTATION OF
THE JET AND STRATE SYSTEMS.***

by

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DECLARATION

I, *Kribashni Govender*, hereby declare that the work contained here is entirely my own except where indicated in the text itself and that this work has not been submitted whole or in part to any other university.

SIGNED AND DATED AT DURBAN ON THIS THE 6TH DAY OF DECEMBER 2000

A handwritten signature in cursive script, appearing to read 'Kribashni', is written above a horizontal line.

KRIBASHNI GOVENDER (MS)

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1. INTRODUCTION

‘Globalization’¹ is a fairly recent phenomenon and it is steadily gaining new impetus. The process of globalization began soon after the collapse of the Berlin Wall in 1989², when Eastern Central Europe began opening their doors to a freer market system. Roger Blanpain³ encapsulates the spread of globalization and he says: *‘some three billion people have joined a worldwide system in which fewer and fewer national borders block the free movement of money, information, technology, goods and services. Companies can and do invest worldwide wherever market conditions are best.’* In view of the globalization process South Africa either prepares for this process or it can simply stand and watch the world go by. The Johannesburg Stock Exchange⁴ which is possibly the largest attractor of foreign investment can play a catalytic role in bringing South Africa in line with global standards and market transition. Being the largest stock exchange in Africa and being classified as an “emerging market” in the global stock market context, the JSE is unique in the sense that it embodies well-established first world as well as third world elements. Ever since South Africa became fully democratised in 1994 investor interest in South Africa has been magnified and many turn to the JSE as a barometer to measure economic development and investor confidence.

¹ The word globalization is also spelt with an ‘s’ instead of ‘z’.

² The collapse of the Berlin Wall marked the death of communism and free reign of capitalism.

³ See R Blanpain ‘Working in the 21st Century’ (1997) 18 ILJ 187.

⁴ Hereinafter referred to as ‘JET’.

It is hence crucial that the JSE lead the way in the globalization process for South Africa and possibly for the African continent. Russell Loubser (currently the executive president of the JSE) categorically emphasised the purpose of the JSE as follows: *'to operate a globally competitive electronic market for buying and selling financial instruments in an efficient, transparent and a secure manner'*.⁵

The JSE has to now extend that role as it now faces new challenges of linking South Africa to the macrocosmic forces, while at the same time ensuring that those linkages are strong enough to be sustained as well as ultimately being able to create a relationship of interdependence with other major stock markets in the global arena.

In 1976 the 'Big Bang' took place in the USA and London followed suit in 1986. In 1996 the JSE closed the open outcry trading floor and introduced dual capacity for stockbrokers, negotiable commission and corporate ownership. Most of South Africa's major banks have become integral role players in the clearing and settlement process. The key focus of this dissertation is to examine (from an empirical perspective) the role of the JSE in the globalization process with specific emphasis on the implementation of the Johannesburg Equities Trading ⁶ system and the Share Transactions Totally Electronic ⁷ system. At one stage the JSE was a hub of physical activity with brokers, traders, jobbers ⁸ and members buying and selling stocks in an open outcry market which resembled a place of an auction. Today with the implementation of the electronic trading system and the dematerialization of

⁵ Annual Report by the Johannesburg Stock Exchange, 'Powering Ahead' (1991) p1.

⁶ Hereinafter referred to as 'JET'.

⁷ Hereinafter referred to as 'STRATE'

⁸ In the UK up to October 1986 jobbers were permitted to deal only with brokers, not directly with the public. From October 1986 since the Big Bang, the name ceased to be in official use as brokers were entitled to act as agents and principals in share dealings.

share certificates for trading purposes the JSE now unusually exudes an aura of quietness and it is run like any corporate organisation with much of the trading, clearing and settlement processes taking place electronically.

My mini dissertation examines the role of the JSE in the globalization process with particular emphasis on the implementation of the JET ⁹ system and the STRATE ¹⁰ system. Part one examines the concept of globalization and looks into the origin and history of the JSE to provide insight into the birth, development and sustenance of the JSE and helps contribute to a fuller understanding as to why the JSE is the one institution that can usher in these changes that will promote transitional integration of the South African economy with global economies. Part two takes a look at the Stock Exchange Control Act ¹¹ and demonstrates the efforts made by the JSE in conjunction with the regulatory authorities to draw more players into the stock market scene while creating a fair and secure environment for investors. Part three provides an evaluation of the Johannesburg Equities Trading system ¹² and Share Transactions Totally Electronic ¹³. The JET system, introduced in 1996 is essentially an automated order system where shares are ordered and prioritised according to a first come first serve basis and it effectively allows traders and brokers to trade shares from anywhere in the world. STRATE implemented in, 1999 is an initiative by the JSE in it's

⁹ Amendments of and Additions to the rules of the Johannesburg Stock Exchange, rule 5 regarding transactions, trading procedures and disputes has been deleted and substituted by s.50.1 - s.50.7. which allows for electronic trading in securities.

¹⁰ Companies Amendment Act 60 of 1998, introducing a new s 91A in the principal Act. This section provides a legal framework within which uncertificated securities can be issued and dealt within the marketplace.

¹¹ Stock Exchanges Control Act 1 of 1985.

¹² Op cit note 9. Hereinafter referred to as JET

¹³ Op cit note 10. Hereinafter referred to as STRATE.

effort it's to secure electronic clearing and settlement mediums for share transactions. The old clearing and settlement system was risky and involved time delays because of shares being in material form. Transfer secretaries had to also verify ownership prior to the completion of any share transaction. The introduction of STRATE by the JSE makes it the first African Stock Exchange to accommodate share transactions electronically. The JSE has made concerted efforts in boosting liquidity and investment levels in South Africa and the implementation of the JET system as well as STRATE is a clear indication of the JSE's move towards upgrading our markets electronically to facilitate global competition. The role of the JSE in the globalization process is extensive and it was hence necessary for me to limit my research to certain areas, which I have confined to the implementation of the JET system and STRATE. My research on the JSE proved to be intensely absorbing and I enjoyed every minute of it. Currently there is talk of demutualizing the JSE which would be quite interesting.

2. PART ONE

2.1 GLOBALISATION

The collapse of centrally-planned economies (commonly known as communism) in the Soviet Union and Eastern Europe in 1989 and 1990 provided fertile ground for the development of global market economies. After the Second World War (1939 -1945) the capitalist system ushered in renewed growth and expansion that allowed the world economy to experience an economic upswing which lasted about twenty years. This upswing could not be sustained as capitalist expansion had burst its bubble and economic growth slowed down and created problems like government debt, inflation and unemployment by the 1970's.

Part of the economic crisis began with the rise of oil prices by the Oil and Petroleum Exporting Countries (OPEC). Then came the technological revolution; the computer age that transformed all economic and social activities. This computer revolution became the turning point and helped the capitalist system out the crisis to form the catalytic basis for the formation of a new global order. According to Shafika Isaacs ¹⁴ the crisis of the 1970's gave way to the resurgence of neo - liberal political and economic ideas.

¹⁴ Isaacs, S. *South Africa in the Global Economy*, Trade Union Research project (1997) p19

Isaac explains that the neo - liberal agenda is based on the following ideas:

The market rules. This means reduced state involvement in the economy. The state is only responsible for establishing conditions for production and for the supply infrastructure.

Privatisation. This is sometimes called the “restructuring of state assets”. The state sells some, all or parts of its enterprises through privatisation programmes.

Deregulation. This refers to fewer laws regulating the economy. Fewer price controls and subsidies.

Cuts in government spending. This would entail less money being available for welfare programmes in education, health and social security. It also means job losses in these sectors.

Competition. In many cases private firms compete for a share in the market, workers compete with each other for jobs, labour competes with machines.

Outward orientation. In this instance the economy is organised to export goods to be sold on the world market.

Trade liberation. This involves cutting of taxes on imports and industries are no longer protected from outside competition.

Specialisation. The economy specialises in producing what, it is best at on the world market.

Flexibility. In this instance the workplace is organised to suit the needs of the market. Restructuring, rationalisation, downsizing and right - sizing are words associated with flexibility. Workers recognise that these are often just new words for retrenchments.

Individualism. Individuals are free to organise their own lives. If everyone worked for their own interests they would work hard, produce more and the society would benefit from the creation of more wealth.

Neo - liberalism is concerned with universal laws of economic development that can be applied across the board from the most highly developed to the least developed country.

(See at p19 - 20) ¹⁵

This paradigm shift from international economies to global economies is the process of globalization. It essentially involves losing their identities and becoming integrated into the global economy. National economies are no longer seen as separatist with hard and fast rules but economies which adhere to global forces. People are increasingly looking at ways of producing goods and services that meet needs globally and not just nationally.

Networking and forming links between individuals, companies, political, social and cultural groups and governments of the world are becoming the order of the day.

Globalization can thus be defined as *the process whereby the economic, political, social and cultural links between different countries, industries, companies, organisations and individuals of the world are increasing.* ¹⁶

Many authors ¹⁷ describe globalization as the deepening economic interdependence between nations. Malcolm speaks of globalization eroding the efficiency of economic management

¹⁵ Ibid.

¹⁶ Ibid p 21

¹⁷ See Amin S 'Capitalism in the Age of globalization.' (1997); Waters M 'Globalization' (1996)

of national states but he also emphasises that it in no way diminishes their existence.

Waters ¹⁸ refers to globalization as the compression of the world and the intensification of consciousness of the world as a whole, resulting in global interdependence and consciousness of the global whole. He also speaks of globalization as a reduction in the geographical constraints of social arrangements. Herein he defines the establishment of cultural, social and phenomenological linkages between four elements; namely the individual self, the national society, the international system of societies; and humanity in general.

It is evident then that the idea 'no man is an island' emerges and the "gestalt" theory applies where all inhabitants of this world become aware that we are all part of a larger macrocosmic force. The wheels of change are in motion and South Africa has no time to ponder on the effects of globalization: it's a question of 'adapt or die'.

¹⁸ Waters op cit note 17

2.2 THE ROLE OF THE JSE IN THE SOUTH AFRICAN ECONOMY

The JSE plays an important role in providing links to external economies and integrating our economy with macrocosmic forces. Africa has been known as the dark continent for far too long and the world which once attempted to 'discover' South Africa is now awaiting in eagerness to see her illuminate an entire continent. The JSE's role in the globalization process has been phenomenal and other stock exchanges in Africa are looking to the JSE as a mentor. In September 1998, the JSE and the Namibia Stock Exchange entered into an agreement of cooperation with regard to the exchange of technology, skills and information. The areas of possible cooperation with the South African Development Community¹⁹ include the harmonious action of; listing requirements, communications networks, trading systems, clearing and settlement systems and entry level qualification.

The essential role²⁰ of the JSE in South Africa is to: channel funds into the economy, raise primary capital by re-channelling cash resources into productive economic activity, enhancing job opportunities and creating wealth.

The JSE has been classified as an emerging market²¹ and investors are offered the opportunity

¹⁹ Hereinafter referred to as SADC.

²⁰ See 'Guide to the Johannesburg Stock Exchange', p 3.

²¹ These are security markets in developing economies with high economic growth rates instituted to attract investment. See also A Vivanti, P Kaufman 'Global Equity Investing' (1997) p97

of relatively high returns on investments and diversification of their portfolios. Emerging markets are attracting overseas investors and the number of organisations listed on emerging market exchanges is steadily growing. For this reason, the JSE can play a crucial role in attracting overseas investors which will inevitably help boost the South African economy.

2.3 THE HISTORY AND ORIGIN OF THE JSE

The JSE came into existence in November 1887. Gold was discovered on the Witwatersrand in early 1886 and according to Stuart Jones *'the JSE's history has mirrored the fortunes of the gold mining industry that was responsible for its birth and that has determined so much of its existence'*.²² The first share transaction took place in a miner's tent in Ferreira's Camp.

Benjamin Woolan, a London businessman launched the Johannesburg Exchange and Chambers Company with a capital of 5000 which marked the establishment of the JSE. Brokers needed to lodge only 250 with the committee, another 250 as surety, an entrance fee of five guineas and half a guinea as a monthly subscription fee. There were 122 original members in 1887 and because this number grew to a staggering 700 brokers just two years later, the first building was opened in January 1889 at the corner of Simmonds and Commissioner Streets with structured rules and regulations regarding share dealing, listing of companies, commission fees and membership which it mainly adopted from the Transvaal Share and Claim Exchange in Barberton.

The system of 'high change' was used with listed shares being 'called over' in alphabetical

²² See Jones S, 'The JSE Centenary leadership Publication', 1887, p 77.

order before trading began. The volume of clients was so great that trading spilled over onto the area between Market Street and Commissioner Street which was cordoned off by special decree for trading which normally went on till late at night. As mining was capital - intensive overseas investment was needed. This was not difficult because countries like London, Paris and Berlin were already competing in the formation of mining companies.

However the Anglo - Boer War halted business and the JSE closed for two years then re - opened on 24 December 1901. The JSE moved to Hollard Street as the Stock Exchange Committee prohibited its members from dealing in the street. The JSE's rules and regulations followed those of the London Stock Exchange amended to suit the local situation. The JSE was run by an honorary committee of 15 stockbrokers.

D.C. Greig joined in 1892 and became chairman in 1911. He chaired throughout the first world war and with the approval of the Minister of Finance he and his committee decided to close the JSE on 1 August 1914. He made this decision knowing that overseas holders were likely to sacrifice their South African shares at any price in the prevailing international panic, and that South African investors would be ruined in consequence.²³ The JSE re - opened on 15 January 1915. The Stock Exchanges Control Act of 1947 laid down statutory requirements for the operation of the JSE and saw the creation of a Guarantee Fund that

23. See Byrant M. *'Taking Stock: Johannesburg Stock Exchange the first 100 years'* 1987 p33.

offered greater investor protection. The 1950's were characterised by apartheid legislation and discrimination spearheaded by the Nationalist government which came into power.

As this brought about a '*crisis of confidence, internally and overseas, between December 1950 and December 1951 the value of shares traded on the JSE dropped from 1993,7 million to 636,3 million*'.²⁴ The so - called "high change" system of allowing shares to be traded only once its name has been called over was done away with in 1969. This helped boost trading volumes tremendously and saw a flood of new capital raised after the abandonment of this system.

However the market crash in May 1969 sliced off a big chunk of the value of ordinary shares listed on the JSE and soon afterwards an amendment to the Stock Exchange Control Act introduced stricter rules governing speculative activity. Share purchases had to be paid and the scrip had to be delivered within seven business days from the date of the transaction. Short - selling was regulated and a compulsory half payment of shares was enforced. The market capitalisation rapidly increased and as a result the JSE had outgrown Hollard Street.

24. Ibid p 61.

At the end of 1978 the JSE moved to Diagonal Street boasting of a total market capitalisation of R51 billion. Krugerrands were officially listed in April 1979 and coins worth R25 million were traded in the first year. In 1980 the bonds trading floor was opened and because this was such a resounding success the bond clearing house was introduced. The new Development Capital Market sector followed in 1984. The 1985 Stock Exchanges Control Act replaced the old Act of 1947 encapsulating all the amendments to date.

In the nineties which marked the collapse of apartheid and the emergence of democracy a research sub - committee was formed to research an appropriate future structure for the JSE. This committee came up with a report which was approved in August 1995 and encoded as an amendment in September 1995.

This amendment brought about phenomenal change that puts the JSE in line with other international stock exchanges. Some of the changes include the following: the establishment of the South African Institute of Stockbrokers was formed independently of the JSE, the formation of Bond Exchange of South Africa which got its license on 16 May 1999 (responsible for bond trading thereby unburdening the JSE of this task) and the introduction of the JET system²⁵ on 7 June 1996 which saw the closure of the open outcry trading floor in respect of all securities listed.

²⁵ Op cit note 9

The real - time Stock Exchange News Service also known as SENS has been in operation since August 1997. Companies are obligated to disseminate price - sensitive information on the service prior to using any other media outlet. This service is designed to foster market transparency and boost investor confidence.

The implementation of STRATE ²⁶ allows for electronic settlement and requires dematerialization of share certificates in a Central Securities Depository. It enhances security of settlement and brings the JSE in line with international best practice.

²⁶ Op cit note 10.

3. PART TWO

3.1 THE STOCK EXCHANGES CONTROL ACT ²⁷

The first Stock Exchanges Control Act ²⁸ came into existence in 1947. It specifically required the JSE to take out a licence ²⁹ to operate instead of stockbrokers taking out licences. External conduct of the exchange was controlled by the Treasury and the internal conduct was governed by the JSE's own Rules and Regulations which are now known as Rules and Directives. The 1947 Act contained provisions that placed a high degree of restrictions on

brokers. For example, brokers had to lodge with the Treasury their auditors' reports and certificates and restrictions were placed on the alienation and pledge of shares deposited with them or held as security. Brokers were required to have a surplus of assets over liabilities of at least 10 000 and such amounts were to be present in a member's stockbroking business. Brokers were prohibited from buying shares from a client for themselves or selling their own shares to a client.

Further restrictions were placed on clients which included a statutory minimum cover requirement of 50 percent of the cost of shares bought and a compulsory registration of shares within a year.

It is important that statutory requirements are structured to regulate and control stock

²⁷ Stock Exchanges Control Act 1 of 1985. Date of commencement 27 March 1985.

²⁸ Stock Exchanges Control Act 7 of 1947. This Act has been fully repealed.

²⁹ Op cit note 27. See Section 7,8,9 and 10 as amended by s 38 of Act 55 of 1989 by s 10 of Act 7 of 1993 and by s 58 of Act 104 of 1993 and substituted by s 6 of Act 1995

exchanges, in the business of stockbrokers and certain lenders of money against the security of securities in order to offer more investor protection and attract foreign investment. There were several amendments ³⁰ to the 1947 Act and presently the Stock Exchanges Control Act 1 of 1985 is the statutory authority with regard to the JSE. The new Act also encapsulates several amendments that serve not only to consolidate the laws relating to the regulation and control of stock exchanges but to transform our laws and keep them in standard with other international stock market regulations and control.

³⁰

Amendments to the Stock Exchanges Control Act 7 of 1947 include Stock Exchanges Control Amendment Act 1 of 1948, Act 72 of 1951, Act 53 of 1963, Act 93 of 1963 and Act 86 of 1971.

3.2 THE GUARANTEE FUND

The Guarantee Fund was created specifically to offer the shareholder greater protection against any member's liability arising out of the purchase or sale of shares on behalf of a client. Such a fund would make available a specified amount of money for the discharge of a defaulting member's liabilities.

The creation of such a fund in my opinion gave stockbrokers a degree of professionalism and allayed any fears investors had of dealing with stockbrokers. It also established a relationship of trust and confidence between client and stockbroker. Previously, stockbrokers out of fear of being sued by clients become overcautious in their dealings and do not explore the market fully. Investors on the other hand shy away from the stock market for fear of being '*done in*' by unscrupulous brokers.

Such is the importance of the Guarantee fund that the present act caters for the establishment and maintenance of more than one guarantee fund.³¹

³¹ See s 30 of the Stock Exchanges Control Act 1 of 1985.

3.3 LISTING REQUIREMENTS OF THE JSE

Presently the JSE has three listing categories³² based on international standards namely; the main board, the Development Capital Market and the Venture Capital Market. The Development Capital Market was established in 1984 to open new avenues of economic development with its lower listing and disclosure requirements. In 1989 the Venture Capital Market was established specifically to allow new companies an opportunity to list and raise capital for risky operations.

The objective of the listing requirements is to protect investors against any unscrupulous dealing on the stock market. Furthermore it gives the JSE's rules and directives force of law and helps promote fair dealing and sound business practice. The subscribed capital requirement of R2 million in both the main board and the venture capital market, ensures that the company has sound financial backing and muscle to enter the public company sector and it would be in a feasible position to look towards expansion and sustainable growth.

The Venture Capital market does not require a profit history and all that are required is a comprehensive business plan with well-projected financials. This sector is intended to

³² See F, K, L Morgenrood *'The Equity Market'* (1993) p 82.

encourage new businesses to enter into the stock market. The JSE needed to get rid of its '*club*' image where only the age-old stalwart companies dominated the stock market scene and hence the venture capital market and development capital market allow for new companies to enter. The Black Empowerment companies who need the exposure and capital injection can now enjoy the benefits of listing on a stock exchange and attracting local and foreign investors.

3.4 JSE AS THE REGIONAL STOCK MARKET IN AFRICA

There is a distinct shift from individualisation to integration and regionalisation³³ of stock exchanges. With the pressures of global competition necessitating rapid transformations, stock markets are realizing the need to regionalise and even consolidate with other major bourses.³⁴ Of the 18 Stock Exchanges in the African continent, the JSE with its market capitalisation of R1209 billion³⁵ is 15 times more than the Moroccan Stock Exchange which is the second biggest stock exchange in Africa.. According to Darrell Till, who is presently the director of marketing, research and development at the JSE, regionalisation is the only way for the stock market to remain competitive and the JSE is the only exchange on the continent capable of driving the process of regionalisation.

The African Stock Exchanges Association (ASEA) was formed in 1994 and it embraces all African bourses. The JSE has been prompting the way to harmonizing the African stock exchanges. There have been four areas of progress in harmonisation, which has been initiated by the SADC.³⁶ Listing requirements have been harmonised throughout the SADC, based on the JSE's listing requirements. The ASEA have also agreed in principle to utilizing the JSE's listing requirements which is already based on international standards, as

³³ See E. Ryan, '*Doing Business in Africa: SADC regional stock market is proposed, Enterprise.*' Nov (1999) p 47.

³⁴ An example of this consolidation is the merging of NASDAQ and AMEX in October 1998. Also in March 1999 LSE (London Stock Exchange) and Frankfurt announce plans to consider creating a pan - European exchange including Paris, Zurich, Milan, Madrid, Amsterdam and Brussels.

³⁵ Op cit note 33. Figures as at 30 April 1999.

³⁶ Op cit note 19

the standard for all African exchanges. Secondly the exchanges have harmonised entry - level examinations and education standards for all people entering the stockbroking profession which is based on the London Institutes entry level.

Thirdly, the SADC is working on a central depository system but they are in need of funds and sponsors. The Stock Exchange of Mauritius has a central depository system in place which four other stock exchanges have indicated they are prepared to use. This will conflict with the STRATE ³⁷ system which JSE is presently using. Fourthly the JSE has offered use of its trading and surveillance systems under STRATE to other exchanges in the SADC at reduced rates in its efforts to solidify the harmonisation of African stock exchanges as part of the JSE's role in the globalization process.

³⁷ Op cit note 10.

4. PART THREE

4.1 THE JET SYSTEM

4.1.1 ORIGIN

The National Market System ³⁸ which came into operation in the US in 1979 works as follows; a single computer stores all limit orders for eligible securities and a stockbroker in his capacity as an agent or principal can load, cancel or modify these limit orders directly. Furthermore all broker-dealers would have equal access to information electronically and orders will be executed on strict price-time- priority.

The key benefits of the National Market System include the following: the system is technologically feasible, actual savings would be extremely high on the system, cost of transacting will be reduced and markets would become more liquid because of the reduction in the cost of transacting and increased competitiveness.

The drawbacks ³⁹ of the National Market System include the following: the system might be technologically impossible; stock exchange floors and the specialist system would disappear; dealer markets may substitute the agency - auction market and there is a possibility that quality of markets may deteriorate.

³⁸ See J H Lorie. 'Conjecture on the Securities Industry' (1982) discussion on National Market Systems; B. Schwachz. 'Impending Changes for Securities Market'. 1979 p54.

³⁹ Ibid p33

The present JET system mirrors the National Market System of the US. In 1986 the London Stock Exchange instituted major changes to the methods of operating that helped make the equity markets more competitive and accessible to a greater number of market players. These changes included the abolition of fixed commission, single capacity roles of jobbers and brokers, floor - trading and the introduction of electronic trading (which was done via computers and telephones).

These changes proved to be quite cataclysmic and hence the term '*Big Bang*' was used.

Prior to the '*Big Bang*' there were jobbers and brokers. Jobbers stood on their pitches on the market floor giving bid and offer share prices to brokers who dealt with investors.

Brokers were not allowed to hold stocks in their own books whilst jobbers were not allowed to deal directly with clients. After October 1986 brokers could act as principal or agent and commissions were negotiable. The floor trading in the London Stock Exchange ⁴⁰ was abolished in 1986 and replaced by a quote - driven SEAQ ⁴¹ system. On October 20, 1997 the LSE switched to SETS⁴² which partially replaced the quote - driven system only for the top 100 organizations.

The open outcry trading floor of the JSE in Diagonal Street closed in June 1996 and was

⁴⁰ Hereinafter referred to as LSE.

⁴¹ Stock Exchange Automated Quotations. This system is still used in LSE for organizations not in the top 100.

⁴² Stock Exchange Electronic Trading Service. SETS is an order driven system similar to JET but SETS is only available for the top 100 organizations in the LSE.

intention to sell securities by means of a bear sale⁵⁰; the hours of the business of the JET system.⁵¹ Only members shall be permitted to enter orders and execute transactions through JET.⁵² Members can only deal as a principal with a client unless such member has prior to trading obtained a client mandate in the form prescribed by the Committee.⁵³ A member is also required to disclose whether he is acting in his capacity either as agent or principal in every trade.⁵⁴

⁵⁰ Ibid 5.50.4.4.

⁵¹ Ibid 5.50.4.5

⁵² Ibid 5.50.5

⁵³ Ibid 5.50.6

⁵⁴ Ibid 5.50.7

4.1.2 COMPONENTS OF THE JET SYSTEM

The system market works:

The JET system has two components, i.e. Market Works and Automated Order matching.

Market Works contain trading and market information as one package. Users can access the Market Works functions with standard window menus or icon buttons. The facilities include trade entry, order entry, look - up, edit and cancellations. Investors and stockbrokers find the new facility particularly useful in terms of the real time market data and graphic displays that help get a feel of the stock market.

Automated Order Matching

Automated Order Matching is the real powerhouse of the trading system. It stores all the data, matches the buy and sell orders and services requests from the users. It organises all orders on the principle of price and time priority, i.e. orders registered in its order book are arranged from best price to lowest price and then also in time sequence of entry. The best price for the day ranks above all and the principle of the 'first come first serve' applies.

Where price offers are the same, the first order entered at a specific price has priority over later orders at the same price.

The workings of JET

Shares and stocks are usually traded in lots of hundred and any lot other than 100 is regarded as an odd lot. The JET system accommodates the small investor to trade odd lots at minimum cost via a specialist and the sale takes place at the next sale price after the odd lot order has been entered into the JET system. A different order book takes care of other

trade terms that may be requested. The JET system operates on weekdays from 08h45 to 18h00 (excluding public holidays). The day begins with pre - opening, followed by opening which is at 09h30 and continues to 16h00 with a run - off period between 16h00 and 18h00.

The introduction of JET converted the JSE's trading procedures from a manual driven institution to an electronic driven one that is now capable of handling larger trading volumes from anywhere in the world. It is apparent that the JET system ⁵⁵ is welcomed and one of the major strong points of the system is that it is fair and allows the small broker to trade without being jostled about by the larger stock brokering firms, as everything is electronically done according to time of order and not size of order. With the introduction of dual capacity where the broker can play the role of both principal and agent and the advent of negotiated commissions the larger stock broking firms are in better position to attract more clients than the smaller broking firms. The abolition of fixed commissions, single capacity ⁵⁶ roles and the replacement of floor trading by electronic trading systems, is indicative of the JSE's effort to make equity markets more competitive and accessible to a greater number of market players.

⁵⁵ From my informal discussion with stockbrokers at Merrill & Lynch Investee Securities, they expressed their delight with the electronic trading system which significantly increased liquidity levels and trading volumes.

⁵⁶ Previously members of the JSE could only serve in their single capacity as agent. A stockbroker can now act either as principal or agent.

4.2 STRATE ⁵⁷

4.2.1 OVERVIEW

STRATE was motivated by the JSE in its effort to strive for a secure electronic clearing and settlement medium for share transactions. It is presently a separate company owned by Central Securities Depository Participants ⁵⁸ and the JSE. This has been a joint venture by the JSE, banks and the share registrars. STRATE Ltd is an approved Central Securities Depository in terms of the Custody and Administration of Securities Act 85 of 1992.

It is a newly formed unlisted public company which came into operation effectively from November 1999. It replaces the paper-based system ⁵⁹ of settlement which relies on share certificates as proof of ownership, transfer deeds for transfer of ownership and cheques for payment. It is known as the '*scrip less system*'. ⁶⁰ All the necessary ownership information will be stored electronically with exhaustive controls and protection measures in place.

Share certificates are surrendered in exchange for the electronic records of share ownership.

⁵⁷ The acronym STRATE for share transactions totally electronic authorized in terms of our laws by Company's Amendment Act 60 of 1998 introducing a new s91A in the principal act.

⁵⁸ Hereinafter referred to as 'CSDPs)

⁵⁹ This refers to the physical movement of share certificates or scripts to affect transfer of ownership and on transfer a new certificate must be issued to the transferee.

⁶⁰ The idea of a 'certificateless society' was first introduced in 1979 by a computerized system for the clearing and settlement in the LSE called TALISMAN or Transfer Accounting Management for Jobbers. See FR Malan '*Collective Securities Depositories and the Transfer of Securities*'. 1984 p 115.

The concept of ‘scrip bank’ was first outlined in 1971 by the President of the Johannesburg Stock Exchange: ⁶¹ *‘It is a well known, of course, that a central electronic registry of share ownership without the issue of share certification is expected to solve the problems with which stock exchanges all over the world have been faced in coping with backlogs in delivery of scrip.’*

One of the major problems in the past was with clearing and settlement houses sustaining a backlog due to extensive trading volumes. This system alleviates this problem and ensures a more proficient clearing and settlement system that will be able to cope with present and futuristic volumes. It is one of the fundamental changes that guarantees the JSE entrance into the global arena and puts it in line with other major stock markets in the world. Share certificates brought with it problems relating to theft and fraud ⁶² and the STRATE system reduces this risk and affords the shareholder greater protection. ⁶³

The settlement period from date of transactions is drastically reduced. Previously it was seven business days from the date of transaction, then it was reduced to five business days. After this system has been fully integrated with regard to all listed companies, this period is likely to be reduced even further to three business days which would bring the JSE in line with other international stock markets like the New York Stock Exchange.

⁶¹ Johannesburg Stock Exchange Annual Report 1971 cited in ISSA 2 *Country Reports South Africa* 399.

⁶² See discussion on tainted scrip p 40.

⁶³ See discussion on dispossessed members fund.

Market capitalisation and liquidity are the two key factors that promote growth of stock exchanges and the implementation of the STRATE system will only serve to favourably influence these growth factors for the JSE. STRATE is based upon international standards and systems, and it will be a fundamental draw card to foreign investors as it will boost investor confidence in the JSE and play a major role in the globalization process.

The STRATE system will be gradually phased in over a two-year period. In September 1999, as a pilot programme, Harmony ordinary shares and Harmony options were dematerialized.⁶⁴ Trading started on the 25th October and electronic settlement came into function on the 1 November. A review of Harmony ordinary shares and options under the STRATE system reveal a resounding success story. An average of 130 settlements of Harmony ordinary shares per day were recorded and all settled five days after trading without a single failure to the market.⁶⁵

4.2.2 ORIGIN

STRATE has been modelled from the Swiss electronic settlement and clearing system (SECOM) which has been in operation since 1993. This system was developed by Tata

⁶⁴ See discussion on dematerialization p35.

⁶⁵ Johannesburg Stock Exchange. Annual Report 1999 cited in *Powering Ahead* p 12.

Consultancy Services, one of the top software producers in the world. SECOM has been also installed in India's National Securities Depository. The system has most certainly increased trading volumes in both Switzerland and India. Failed trades have been reduced substantially and transaction fees have dropped.

The Southern African Financial Instruments Real - time Electronic Settlements System⁶⁶ bought from Switzerland's Central Securities Depository, SegalInterSettle. SIS SegalInterSettle is one of the six companies appointed to build and run the transaction flow monitor on behalf of the Global Straight - Through - Processing Association. This association has been set up to establish and run a transaction flow monitor for the global securities industry. The new trade processing system is expected to have a positive effect on cross border settlement with regard to securities in the future. The fact that the JSE has aligned itself with SIS SegalInterSettle who is presently helping transform the securities industry worldwide; is indicative of its progress in the globalization process as it is already conforming with requirements of Global Straight - Through - Processing.

The SECOM system which was bought from Switzerland had to be developed, customised and properly implemented in South Africa. STRATE out - sourced this vital function to Tata Consultancy Services, an Indian Software company which actually developed Swiss

⁶⁶

Also known as SAFIRES

SECOM. India who used Tata Consulting Services implemented the SECOM system sometime in 1998 in the National Securities Depository Limited in 1998. After successfully implementing the system in India Tata consulting services were contracted to customise the system in South Africa. They have been involved with STRATE since inception and incidentally they also headed the SECOM project for the Swiss Central Depository in 1993.

4.2.3 STRUCTURE OF STRATE

The STRATE project is initiated and managed by the JSE in its effort to bring the JSE in line with global markets. The major role players in this project are: the Banking Council, the Fund Managers' Association, the Transfer Secretaries, the Shareholders' Association, the Financial Services Board and the South African Reserve Bank.

The General Manager is Monica Singer, the IT manager is Shah Ebrahim, the Back Office Manager is Brian Balkind and the Marketing Manager is Linda Newton - Thompson. The staff of STRATE are all JSE employees.

4.2.4 THE CENTRAL SECURITIES DEPOSITORY PARTICIPANTS ⁶⁷

The CSDPs are financial institutions under either the Financial Services Board or the

⁶⁷ Hereinafter referred to as CSDPs. See Companies Act of 1973 section 91A for definition, powers and restrictions of CSDPs.

Registrar of Banks.

Presently there are 8 CSDPs viz. ABSA Bank Limited, Citi Bank, N.A, Credit Agricole Indosuez South Africa, First Rand Bank Limited, Mercantile Bank Limited, Nedcor Bank Limited, Societies Generale and the Standard Bank of South Africa.

The CSDPs have accounts at STRATE Ltd which is the Central Securities Depository showing the shareholding quantity that has been dematerialized. Every CSDP will also keep records of its clients' shareholding and it will liaise with the Central Securities Depository on a daily basis to verify records. The CSDPs function is to control the share and money accounts required to settle a share or facilitate transfer of funds for settlement. Transfers are normally done within a specific time period. After dematerialization, investors will receive monthly statements from their appointed CSDP which will suffice as prima facie evidence of ownership. If an investor wants to sell his shares, they must be dematerialized by a CSDP or the JSE member⁶⁸ (the stockbroker) which the investor deals with.

⁶⁸

Op cit note 47.

4.2.5 DEMATERIALIZATION

Dematerialization can be defined as the process whereby share certificates are surrendered in exchange for electronic records of share ownership reflected in accounts at the CSDPs.

Although eventually all shares will at some point have to be dematerialized, it is currently done in phases. Listed companies will dematerialize on different dates and hence the investor will be notified via the media of this date. After this date, the investor can dematerialize anytime thereafter. As an incentive to fast-track the process of dematerialization, investors can dematerialize share certificates free of charge for the initial 6 - week period following the date of dematerialization.

All shareholders wishing to sell their shares on the JSE have to dematerialize their share certificates, as only uncertified securities can be used to settle transactions through the STRATE system.

After dematerialization the investor will receive a regular statement of his share account. Dematerialization is not compulsory as the investor can choose ⁶⁹ to hold onto his share certificates but if at some time he wishes to sell he will have to dematerialize as well.

⁶⁹ See Section 91A 10(a) of the Companies Act 61 of 1973.

Section 91A(7)(b) allows an investor to withdraw his uncertified securities held by the participant and to obtain a certificate in respect of all or part of those securities subject to certain conditions.⁷⁰ Although the law aims to protect investors, especially individual investors, the provision that allows the investor to rematerialise, does not afford the investor any protection, but contrarily introduces the problem of tainted scrip once again. A shareholder holding shares in a dematerialized form is actually in a better situation than a shareholder holding shares in certificated form. Why then allow for re-materialization?

The law should ensure shareholder protection as well as prevent unfair practices. Section 91A(7)(b) supposedly gives the shareholder greater options (that is to dematerialize or rematerialise whenever he prefers) but is it quite counter-productive as it neither protects the shareholder nor does it prevent unfair practices such as fraud, theft and tainted scrips.

Clearing and settlement will be done electronically via your CSDP. Bearing in mind that the major problem with share certificates is theft and fraud, it would be in the investor's best interest to dematerialize his shares as it reduces this risk.

Section 91A (7)(b) should instead give the shareholder the freedom to transfer his uncertified securities to another participant, as CSDPs are in strong competition with each other

⁷⁰ Ibid Section s 91A 7(b) (i) - (iv).

would offer negotiable rates to investors. By amending this provision the law would help foster competitive practices and clog up the holes that would encourage malpractices.

One enormous problem linked with the process of dematerialization is the possibility of the old share certificates being stolen or the likelihood of a high incidence of fraud. Fraudsters may use the dematerialization process to officially put stolen shares in their own names.

Dematerialization which is intended to curb the problem of tainted scrips will not only reduce fraud if a thorough pre- validation check is done prior to dematerialization.

*'Due to the high incidence of fraud being experienced it was decided that it would be in the best interest of the CSDP and the market in getting ready for the dematerialization process for a pre - validation check to be introduced.'*⁷¹ The pre- validation check will safeguard investors and authenticate holders of shares with the real owners of the shares by electronically cross- referencing with custodians of share certificates and CSDPs and Transfer Secretaries comparing with Share Registers.

One of major criticism that can be levelled against the dematerialization process is that it can easily forfeit the purpose it was designed for. Although pre - validation checks can allay the fears of investors STRATE only takes cognisance of custodians of large number of

⁷¹ Strate Talking Newsletter, 5th Issue, March 1999, p4

certificates and leaves the investor who safe- keeps his own share certificates susceptible to fraudulent practices. It seems that in these cases dematerialization will favour possession in recognition of possession being nine tenths of the law. However, the formation of the Dispossessed Members Fund should help to remedy this problem.

4.2.6 LIABILITY IN THE PROCESS OF DEMATERIALIZATION OF SHARE CERTIFICATES

Section 91 A (8)(a) to (c) outlines the liability of any person who takes any unlawful action with regard to removing or omitting names in the register or sub - register, increasing or reducing the number of uncertificated securities or changing the description of uncertificated securities in these registers.

Section 91 A (9)(a) states that a person who gives an instruction to transfer uncertificated securities shall warrant the legality and correctness of any such information. There seems to be some concern over this provision as the legal nature of the entering of the name in the sub register of the CSDP is not covered in this position. This provision covers the 'transfer' of uncertificated securities and as the entering of the name on the sub register is essentially a 'switch' ⁷² from certificate to book - entries in the accounts of the CSDP, the CSDP participant is left to liability.

⁷² See Maria Vermaas 'Liability in the Process of Dematerialization of Share Certificates.' (1999) II *SA Merc LJ* 132.

Vermaas ⁷³ in her article on liability in the process of dematerialization of share certificates points out that it seems only fair that as in Australia law ⁷⁴, the party cancelling the certificates after verification (in most instances this would be the transfer secretaries) should be the party bearing the risk of tainted scrip. In her article Vermaas submits that transfer secretaries' responsibilities in the process of dematerialization should be determined and delineated under the rules, directives or '*Dematerialization Business Model*' ⁷⁵ of STRATE Ltd. I tend to agree with Vermaas as the dematerialization process is crucial to STRATE Ltd and rules and directives should certainly be put in place at the outset to obviate problems in future.

⁷³ Ibid p135.

⁷⁴ Ibid p126.

⁷⁵ Ibid p135.

TAINTED SCRIP⁷⁶

A share certificate shall be *prima - facie* evidence of the title of member to such shares or stock.⁷⁷ In the case of a share certificate being lost or stolen, it can subsequently be traded with a forged transfer document. This kind of fraudulent transfer leaves the rightful owner bereft of his title and he will no longer be reflected in the register of members as holder of the security. Instead, the subsequent holder of the tainted scrip will be recorded in the company's register as the member.

In the case of uncertificated securities, in terms of Section 91A(9)(a)⁷⁸ a person who gives an instrument to transfer uncertificated securities shall warrant the legality and correctness of any such instruction. The intention of this section is to place greater accountability on the person giving instruction rather than placing any reliance on transfer documents which can be easily forged. Section 91A(8) further outlines the liability of a person who takes any unlawful action especially with regard to fraudulent events that occur in a register of a company or sub- register of a CSDP.

Section 138⁷⁹ covers the warranty and indemnity of persons lodging documents of transfer either as principal or agent. Section 138(1) deems that the person lodging the document

⁷⁶ This problem arises when genuine share certificates belonging to rightful owners are lost or stolen and subsequently negotiated with a forged transfer document

⁷⁷ See Section 94(i) of the Companies Act 61 of 1973 substituted by 56 of the Companies Amendment Act 70 of 1984.

⁷⁸ See Companies Act 61 of 1973.

⁷⁹ Ibid. as substituted by s 7 of the Companies Amendment Act 35 of 1998.

warrants that such document, (excluding a certificate of ownership or any other document evidencing title to such security) is genuine and also indemnifies the said company against any claim made upon it and against any loss or damage suffered by it arising out of a transfer⁸⁰ registered by the company.

The intention of this section is to place greater accountability on members of the JSE, i.e. the stockbrokers either in their capacity as principal or agent. Section 138(2) on the other hand gives recognition to the existence of lodging the documents in 'good faith' as well as if there is any partial negligence on the part of both stockbroker and company. These sections give the shareholder greater protection whilst at the same ensuring justice and equity for both company and member.

Will STRATE Ltd obliterate the problem of tainted scrip?

Dematerialization will certainly curb the problem of tainted scrip. The problem lies with the fact that the shareholder is given a choice to retain his securities in certificated form and even to re-materialize⁸¹ certificates after dematerialization. As long as the shareholder is given the choice of holding his securities in certificated form, the tainted scrip problem will recur. The Dispossessed Members Fund acts as a remedial measure for shareholders who have been subject to fraud or theft but it does not act as a preventive mechanism. The only way

⁸⁰ *Moosa v Lalloo and another* 1957 4 SA 207(d) 221 - 223; *Oakland Nominees (Pty) v Gelria Mining and Investment Co (Pty)* 1976 1 SA 441(A) 453.

⁸¹ Op cit note 79.

STRATE Ltd can resolve this problem with tainted scrips is if dematerialization of share certificates are made compulsory as soon as the company is STRATE approved. For this to be implemented section 91 A(7) should be revised to permit the shareholder the right to transfer the dematerialized securities to a CSDP of his choice rather than give him the option of re materializing his shares. It is apparent that dematerialization of securities is encouraged and investors who wish to trade on the JSE will be required to dematerialize their certificates as all transactions on the JSE will be required to be settled through the STRATE system.

The decision to allow both systems to operate will eventually only dilute the efficacy of an electronic clearing and settlement system and the JSE's ultimate purpose of increasing liquidity and attracting foreign investors would be thwarted. South African investors need to be amenable to changes and there is a need for investors to stop clinging to old systems which supposedly give the investor a sense of security. An investor who decides not to dematerialize does so presumably either out of ignorance, fear of placing any reliance on technological records, or because of anti- transitional attitudes.

One of the lessons of globalization is the need to transform quickly. The introduction of STRATE Ltd is a step in the right direction but the implementation procedures have to be done in such a manner that will facilitate an effective and smooth transition. The problem of tainted scrips can only be resolved if dematerialization is made compulsory and re-materialization of share certificates is completely done away with.

4.3 DISPOSSESSED MEMBERS' FUND

This Fund has been established to provide compensation for those shareholders who have been removed from the register without due cause. The thinking behind this fund was obviously to allay the fears of investors with regard to the tainted scrip problem and the dematerialization process. With such mechanisms in place investors are encouraged to use the stock exchange as an avenue to raise capital and increase savings. If the threat of falling victims to tainted scrips remains a daunting one, investors would shy away from the stock exchange and this would have disastrous results. In fact, STRATE Ltd (quite contrary) was designed to attract more investors and increase liquidity on the JSE by fast - tracking the stock transactions via an efficient electronic clearing and settlement system. The Fund consists of contributions to the approximate value of R 93 million and can meet cumulative claims up to the value of R 2 billion.⁸² The Fund will have an independent panel of adjudicators appointed by the trustees. The Disposessed Members' Fund creates a source of compensation for members who may inadvertently fall prey to fraudulent actions and who have been removed from the register without due cause. The Fund comprises of contributions from four categories of players. Their contributions have been apportioned in terms of benefits the players would derive from the elimination of the tainted scrip problem.

⁸² 'STRATE Legal Guide for Shareholders', Strate Ltd(2000) p6

'Currently indications are the CSDP's will each contribute in the region of 39% of the Fund, the JSE brokers will contribute approximately 17% and shareholders will contribute 5% (shareholders will contribute through payment of an advalorem transaction levy on trades of all non - dematerialized shares. This fee will be levied by the JSE on its members in terms of section 11A (1) of the Stock Exchanges Control Act of 1985. It will be in the discretion of the members to pass on the cost to the purchaser. ' ⁸³

It seems fair and well that contributions are made on a proportionate basis of benefit but how then do we justify the shareholder's contribution.

Should shareholders contribute to the dispossessed members fund?

The advalorem transaction levy on trades of all non- dematerialized shares seems to be unjust. This is so, firstly because the shareholders have no control over when the company decides to dematerialize its shares. As a result, shareholders of for example Harmony Gold Mining Company ⁸⁴ who have dematerialized their share certificates will not be subject to these levies whereas shareholders of another company who have not dematerialized as yet

⁸³ Ibid p6

⁸⁴ Harmony Gold Mining Company was the first company to go onto the STRATE system in November 1999.

will have to pay this levy even though they are keen to dematerialize their shares. It is certainly a punitive measure and unjust as shareholders are not treated equally; and differential treatment of shareholders would not be in the interest of shareholders.

Section 11 A(1) of the Stock Exchange Control Act of 1985⁸⁵ caters for the committee requiring members to contribute towards the funds of the stock exchange as a contribution towards carrying on the business of such stock exchange. In view of this provision, the members contribution would be justified and there is no need to expect the shareholder to contribute to this fund.

It is important to ensure that all members⁸⁶ contribute to this fund as all shares will eventually be dematerialized. Here again contribution by members should be determined in proportion to their shareholding portfolios both in their capacity assumption of principal and agent. The member has the discretion to pass this cost onto the investor which will in this case be fair, as the member's commission is based on the value of the transaction which is negotiable anyway.

The abolition of fixed commissions will compel members to keep their commission rates as reasonably as possible. This would help foster greater competition among members of the

⁸⁵ Section 11A introduced by s 11 of the Stock Exchanges Control Amendment Act 54 of 1955 and amended by s 3 of Stock Exchanges Control Amendment Act 71 of 1996.

⁸⁶ Membership to the JSE is governed by the Rules and Directives of the Exchange and the Stock Exchanges Control Act 1 of 1985 as amended. Members are mainly stock brokers who are required to hold a minimum number of Stock Exchanges Rights. In the case of a sole proprietor as a stock broker he has to have a minimum of 3 Rights; a partnership - a minimum of 3 Rights per partner up to a maximum of 60 rights; corporate entity with unlimited liability - a minimum of 3 Rights per director and a maximum of 60 rights; corporate entity with limited liability requires a minimum of 60 Rights. Non - stock brokers can be members only in corporate entities where minimum requirements are complied with.

Dispossessed Members Fund, is the so called '*benefit*' criterion that is applied to shareholders. It is reasonable to assume that issuers, JSE members and CSDPs benefit from the Fund; but how do shareholders benefit from the fund? The fund has been created for the explicit purpose of compensating shareholders who have been dispossessed of their title without due course. If a shareholder '*lost*' his shares and this was attributable to his own negligence he would not succeed in his claim anyway as the claimant will have to show that the loss was not due to the claimant's own fault or negligence? Where then is the benefit to the shareholder?

The Dispossessed Members Fund will subsist only until the completion of dematerialization. In terms of section 11A (2) ⁸⁷after the process dematerialization has been completed the committee of the JSE can resolve to distribute surplus assets to members. The remaining assets of the Dispossessed Members Fund shall be returned to the original contributors. Section 11 A(2) authorises distribution to '*members*' and not shareholders. Even if shareholders were to contribute to the Dispossessed Members Fund they would not get

⁸⁷

See op cit note 85

back any of their original contribution. I submit therefore that shareholders should not contributed to the Dispossessed Members Fund as it would amount to a travesty of justice.

I fervently believe that as long as the JSE wants to broaden its base of shareholders this business of ripping off the shareholder should be completely eradicated. There seems to be an apparent contradiction in categorising shareholders as players who benefit from the fund while at the same time the Fund has been established for the sole purpose of compensating dispossessed members. Compensation is a way of '*making good*' some loss or damage (either patrimonial or non - patrimonial) suffered by the shareholder. How can compensation to a shareholder be regarded as a benefit to him? All the Fund offers the shareholder is some recourse if he is dispossessed without due course. I therefore feel that shareholders should not be contributors of this Fund as they are the ones the Fund seeks to compensate if a rightful shareholder is dispossessed of his title. They cannot be "victims" and "beneficiaries" at the same time. Furthermore a payment of an advalorem transaction levy on trades of all non- dematerialized shares is discriminatory as shareholders with scrips will be further prejudiced. Although these percentages are not finalised, I would like to see them reviewed as making shareholders contributors of this Fund is farcical and unjust.

No doubt, the Fund has its advantages. In order to succeed with a claim against the Fund, the claimant will have to show that: he or she was the member of an Issuer; he or she was removed from the register (of shareholders) without due course; the lost shares had already been dematerialized and were already reflected in the electronic securities register; the loss was not due to the claimant's own fault or negligence, and he or she has a reasonable chance of obtaining a rectification order in terms of Section 115 of the Companies Act of 1973.

The claimant shall be called upon to provide documentary evidence to the above including: an affidavit signed by the issuer or its agent, confirming that the claimant was a member of the company, or has a right to be entered onto the register of the company as one of its members; the date on which the claimant was removed from the register; the circumstances in which the claimant was removed from the register (where applicable); certified copies of any records of the issuer or its agent, supporting the facts set out in the issuer's affidavit.

The claimant shall upon application to the Fund, sign an agreement: giving the Fund access to any information (whether held by an issuer or any other party) relating to the lost securities or the circumstances of their loss; waiving the right to any confidentiality which the claimant may have against any person withholding such information; undertaking to cooperate with the Fund in all reasonable ways (including delivery of any documents) in the investigation of the circumstances of the loss and in recovering such loss from any person.

Discretion with respect to the compensation of dispossessed members shall be exercised on behalf of the Fund by an independent panel of adjudicators appointed by the trustees. This panel shall be appointed by the trustees for the lifetime of the Fund and shall combine legal expertise, industry experience and surveillance knowledge. The panel shall exercise it discretion having regard to the provisions of s115 and the case law precedents dealing with the application of s115.

In particular the panel shall have regard to: whether there has been any undue delay between the time at which the claimant's name was removed from the register and the time at which he became aware of such removal; whether there had been any undue delay between the time at which the claimant became aware of his claim against the Fund and the time at which the

claim was brought against the Fund; whether the claimant was privy to any illegality or fraud, or otherwise at fault, as a result of which the disputed removal of his / her / its name from the register occurred; the reasonableness of any errors relating to the disputed removal of the claimant's name from the register, and whether the claimant is relying on his own neglect and mal - administration in bringing in the application; and any contractual evidence of any intention to transfer the securities in question to the claimant, or from the claimant to the subsequent holder.(see at http://196.48/shareholders_rights/dm_fund_how.html)

The dispossessed member may opt to be compensated in money or in kind. The quantum will be calculated in terms of market value of shares on the date of settlement and if compensation is in kind, the claimant will receive securities equivalent to the securities in issue on the date of settlement of the claim. Similar to “The Guarantee Fund”, “The Fidelity Fund” etc. the Dispossessed Members’ Fund serves as a route of recourse to the problem of tainted scrips and is in no way a solution to the problem. These Funds serve a mere cosmetic function to camouflage serious flaws that discourage investors from entering into the stock market. They are just structures put in place to stop the exodus of much needed shareholders in the business of stock markets.

4.4 A SYNOPSIS OF CONTROLLED⁸⁸ AND NON - CONTROLLED⁸⁹ CLIENTS UNDER STRATE

The shareholder, after dematerializing his shares can either hold these securities either in his own - name or in the nominee name of an intermediary.

4.4.1 CONTROLLED CLIENTS:

In this case the client has an account with a broker. The broker keeps his scrips and the broker makes use of his own CSDP. The client receives a regular statement from the broker.

Members need prior written approval⁹⁰ from the Committee to operate accounts for controlled clients. Mandates⁹¹ from the client is required prior any acceptance of cash and/or uncertificated securities by the member. Any cash received not paid over to the client, by a member shall be deposited in the name of the client with JSE Trustees (Pty) Limited.⁹² Every member is required to keep a mandate and nominee register as prescribed by directive. In terms of rules 14.60.8⁹³ uncertified securities shall not be withdrawn or transferred from the custody account with a CSDP or from the account of the controlled client in the nominee register, unless joint approval is obtained. Joint approval⁹⁴ is intended to offer the client protection against improper practices by nominee holders. Rule 5.320 however requires two signatories i.e. two partners or executive directors and a stockbroker of the member. It seems like this joint approval

⁸⁸ In terms of the Rules of the Johannesburg Stock exchange rule 14 defines '*controlled client*' as a client whose funds and uncertificated securities are under the control of a member and a '*non - controlled client*' as a client other than a controlled client and who appointed his own CSD participant.

⁸⁹ Ibid rule 14.20.

⁹⁰ See rule 14.60.1 of Rules of the Johannesburg Stock Exchange.

⁹¹ Ibid rule 14.60.2

⁹² Ibid rule 14.60.4

⁹³ Ibid

⁹⁴ Ibid rule 5.320.

from partner executive director and stockbroker of the member to withdraw and transfer uncertificated securities from the custody account with a CSDP offers no real protection to the client as fraud can easily take place. Instead rule 5.320 should incorporate approval by the committee or some external body to obviate the possibility of malpractice. Although Broker Real Accounting systems help balance custody accounts with the CSDP, more stringent controls need to be put into place to afford the controlled client greater protection.

4.4.1.1 ADVANTAGES OF BEING A CONTROLLED CLIENT

The main advantage of being a controlled client is that the shareholder's portfolio is managed professionally. Stockbrokers obviously encourage the use of their nominee name as it means more business for them. The client does not have to be burdened with managing his share portfolio as stockbrokers who are clued up on price sensitive information, market developments and trends will be in a better position to trade, transfer and manage share portfolios.

Shareholders also tend to place great value on stockbrokers expertise. From a stockbroker's point of view nominee accounts are encouraged for the following reasons ⁹⁵: it is convenient

⁹⁵ See 'STRATE Talking' Newsletter 10th issue p1.

for the brokers' administration system; it allows the scrip to be held in fungible form, which facilitates easy dematerialization to the STRATE environment; it relieves shareholders of time consuming paperwork and exposure to lost and tainted scrip; it is a cost effective way for brokers to deal on behalf of small investors; and it assists shareholders in collecting dividends and other Corporate Actions.

Another advantage is that clients remain as beneficial shareholders. The broker is able to negotiate good rates with regard to transaction costs because of the volume of trade whereas the non - controlled client is not placed in a better position to negotiate good rates.

4.4.1.2 DISADVANTAGES OF BEING A CONTROLLED CLIENT

The stockbroker chooses the CSDP and cost of transactions are beyond his control. The broker becomes the official registered owner of the shares and the names of registered members will appear in the electronic sub - register⁹⁶ of the CSDP. A major disadvantage is that Shareholders will not automatically receive issuer information. This is one area that can dilute the shareholders rights. A shareholder has the right to receive such issuer information. All major companies are obliged to publish and issue annual reports, interim reports etc. to the shareholder. In the case of nominee accounts, the non - controlled client, will not automatically receive this information as

⁹⁶ See Section 91A(c) of the Companies Act 61 of 1973 as amended by s1 of Act 60

companies are now obliged to send this information to members (nominees) who are the official registered owners of the shares. Members in turn are not obliged to pass this information to the shareholder. The shareholder loses this inherent right to information about the company.

Nominee clients can however request this information from the nominee holder.

A suggestion from one of the JSE members was that the Stock Exchange News Services (SENS) should, at the same as it distributes information to its vendors, send an electronic copy via e-mail to each CSDP and broker. All clients holding that particular counter could also receive such circulars automatically via access to web sites.

The implementation of this electronic mode of communication should: save Issuers in printing / postage costs, provide far more immediate information to shareholders, provide Issuers with the ability to better inform shareholders by issuing more frequent announcements at lower costs, and provide Issuers with a much broader range of information for the web site like newspaper cuttings.

Although the receipt of issuer correspondence involves timely distribution of such information the use of web sites to publish annual reports and it may seem as a good suggestion but it is not practical. This measure would not suffice as it is just a service provided by *some* companies and it does not resolve the problem of access to issuer information to *all* shareholders, as listed companies in terms of Stock Exchange Control Act, are obliged to publish annual interim reports to shareholders. Nominee client lose these rights and it is the broker or member who now assume these rights in their capacity as registered shareholders in the sub - registers of CSDPs. The client is no longer entitled to withhold his identity. Recent amendments to the Companies Act of 1973 provides that companies will be entitled, at any time to demand disclosure of the

identities of the beneficial owners. This amendment was made with the intention of preventing insider trading and offering greater protection to minority shareholders.

A controlled client can either give the broker the mandate to act on his behalf especially with regard to making corporate action decisions on behalf of the client or not give the broker any mandate. In this case the broker will contact the client and request a decision from the client. There are inherent disadvantages of an open mandate⁹⁷ as the broker would in this case represent the client.

The Dispossessed Members Fund does not provide the client with any recourse against the broker for ill - advice, or bad corporate decision - making.

⁹⁷ See *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* (1976) 1 SA 441 (A) 442. The Appellate Division held that there was a difference between (1) a broker's client having his shares registered in the name of his broker's nominee company and (2) the giving of scrip to the broker together with an unqualified power of attorney giving the broker the right, the power to make the client's scrip negotiable at any time. The latter conferred a mandate. The former conferred no mandate, either on the nominee company to the broker to transfer shares. In this case the beneficial owner is entitled to bring an action against a person of share for delivery thereof. The person in possession of 'stolen' shares can only assert his rights to his property where *culpa* is established i.e. he was misled into the belief that the person from whom he acquired it, was the owner or was entitled to dispose of it or where, despite the absence of culpa compelling considerations of fairness within the broad concept of *exceptio doli* preclude him from asserting his rights.

4.4.2 NON - CONTROLLED ⁹⁸ CLIENTS

In this case the client nominates a CSDP, opens an account with his CSDP, submits his scrip, keeps his cash with the CSDP and deals with a broker only when he wants to trade. Such a client receives regular statements directly from the CSDP.

4.4.2.1 ADVANTAGES OF BEING A NON - CONTROLLED CLIENT

The client is registered as an officially registered shareholder as well as a beneficial shareholder. He also receives Issuer Information directly from CSDP.

4.4.2.2 DISADVANTAGES

The client has to manage his own portfolio and he has to fulfill settlement obligation.⁹⁹ The client is not in a position to negotiate better rates from his CSDP in his capacity as a single shareholder.

⁹⁸ Op cit note 89.

⁹⁹ See Section 14.140 of the Rules of the Johannesburg Stock Exchange

4.5 PLEDGING OF SHARES IN STRATE

Ownership of shares form part of personal rights and as such can serve as collateral for the owner. Share certificates can be ceded to financial institutions as security for loan facilities (cession in securitatem debiti). With regard to certificated securities delivery of the instrument would complete the cession. This rule ¹⁰⁰ has been applied in our law where the right is said to be embodied in the instrument. ¹⁰¹

How will pledging of securities now work under STRATE with regard to uncertificated securities?

The Custody and Administration of Securities Act makes provision for a pledge in respect of securities held by a CSDP. An entry is made in the securities account ¹⁰² of the pledger in favour of the pledgee. The term '*flagging*' is used to indicate that such security has been pledged. The Custody and Administration of Securities Act provides that if such securities are flagged, they cannot be transferred by the owner without the written consent of the pledgee. Pledged shares may be held in the name of the owner, a nominee owner or a nominee for the holder of the pledge.

¹⁰⁰ See FR Malan *Collective Securities Depositories and the Transfer of Securities* (1984) p171

¹⁰¹ Ibid para 3

¹⁰² See section 14.20 'uncertificated securities entry' means an electronic recording of any deposit, withdrawal, transfer, attachment, pledge, cession in securitatem debiti or any other transaction in respect of uncertificated securities.

The CSDP would be requested to designate the shares as having been '*pledged*' and to provide a guarantee that pledges would not be lifted without the permission of the holder of the pledge.

The cessionary is burdened with the task of requesting this kind of undertaking from the respective CSDP. The problem with this is that if the cessionary neglects to make this request what claims does he have as a cessionary? Where share certificates that are not dematerialized the cessionary must keep possession of the pledged shares in order to exercise his right as a pledgee in the event of the cedent not honouring his obligation with regard to the loan or debt. When uncertificated securities are designated in a nominee register by a member on behalf of a client, the client may be required as minimum cover to lodge with the member a pledge¹⁰³ in such form as prescribed by the committee.

It is interesting to note that the CSDP's are all financial institutions and pledging of securities for loan facilities would be quite simple. Financial institutions have been drawn into the electronic process of clearing and settlement to speed up the process of clearing and settling share transactions and improve accessibility of pledges via uncertificated securities in order to boost lending facilities and liquidity levels. All stock transactions are now inextricably linked to the CSDP's who are presently financial institutions.

¹⁰³ See section 14.70 op cit note 99.

4.6 STRATE - RELATED COSTS

STRATE has spent approximately R90 million on the project thus far. These costs will be recovered from the CSDPs. The CSDPs STRATE - related costs include subscription costs, registration as a CSDP, transaction costs, business management costs and membership costs. The problem presently is with unnecessary duplication of costs. *Example: A single trade will involve transaction and messaging costs from two CSDPs as well as messaging costs from two brokers. This duplication of costs is referred to as the 'horseshoe problem' and phase 2 of STRATE will proceed after the horseshoe problem¹⁰⁴ is eliminated.*

According to Monica Singer, who presently heads STRATE LTD *'costs may be 60% cheaper under the present paper - based settlement system'*¹⁰⁵. The JSE plans to charge the broker R22.17 for each investor transaction and STRATE intends to charge R6¹⁰⁶. The banks who are the CSDPs and custodians of investors' shares have remained silent about what they plan to charge for their service. In essence investors are left in the dark about the cost of paperless trading.

¹⁰⁴ STRATE talking (11th issue) STRATE publication p1.

¹⁰⁵ Janet Heard 'Calculating the cost of paperless shares' Sunday Times Business section, October 22 2000 p15.

¹⁰⁶ Ibid para 4.

Presently brokers are running two systems i.e. certificated and uncertificated transactions and costs are subsequently high. It is hoped that all the players especially the JSE, STRATE Ltd, the CSDPs, and the members of the JSE (brokers) try to absorb most of the unavoidable costs involved and not pass these costs on to the investor.

It is in this regard that the JSE should take the lead and find ways of reducing the costs of the scripless system. Such an initiation by the JSE would magnify the JSE's role in the globalization process. I believe phase 2 will only truly come to fruition with the financial help of the JSE that is much needed to muscle the process ahead. This problem with STRATE- related costs is easily solvable as all the players in the equation have the capacity and power to absorb costs. With the introduction of negotiated commissions the broker can reduce rates and the CSDPs who are essentially the banks can offer discounts to clients who bank with them. It is important that all these players in the equation see the broader picture and not try to make an overnight killing as this would cripple the process of globalization.

5. CONCLUSION

The JSE's role in the globalization process will be an ongoing commitment in view of its vision to be recognised for excellence as a world leader in fully integrated electronic financial markets. The JSE has broken record in key performance areas.¹⁰⁷ Since 1996 trading volumes, liquidity, share indices and market capitalisation have all reached all time high's. The introductions of JET in 1996 and STRATE Ltd in 1999 by the JSE have all contributed to the increased productivity figures. The implementation of JET went smoothly and it certainly helped protect the interests of small traders and brokers. It levels the playing field for the once disadvantaged small brokers, it makes possible the handling of larger trading volumes, it improves liquidity and it prepares the market for international investors. The implementation of STRATE was a big step forward for the JSE in preparing the stock market for global trading. The introduction of the paperless system of clearing and settlement is an arduous task and it can only be phased in over a period of time. The main objective is to increase operational efficiency and reduce failed trades.¹⁰⁸ The D v P¹⁰⁹ period has been reduced and it is a sure sign of operational efficiency and effectiveness.

¹⁰⁷ 'Powering Ahead' Johannesburg Stock Exchange Annual Report (1999)p9

¹⁰⁸ Failed trade refers to a transaction in uncertificated securities which fails to settle on the settlement date. See section 14 'Transactions in State Approved Securities' Johannesburg Rules and Directives introduced with effect from 30 September 1999.

¹⁰⁹ D v P refers to delivery versus payment. This period was initially T + 9, i.e. clearing and settlement taking place nine days after date of trade. Presently with STRATE this has been reduced to T + 5.

However the process of electronic settlement needs to be driven more rapidly and there is a need for the JSE to take ownership and responsibility of this process and to help see the system ushered in to its successful completion. Phase two of STRATE has been delayed. The JSE needs to assume the role of a mentor over impending changes. Furthermore the shareholder should be protected at all costs. Expecting the shareholder to contribute to the Dispossessed Members Fund would amount to a travesty of justice and the right to issuer information by controlled clients needs to be looked into. What is also needed, is clarity about the costs of the paperless system of trading to the shareholder. Transfer secretaries need to start preparing their registers for dematerialising share certificates and the law should review the need to allow shareholders the option of rematerialising share certificates after having dematerialised share certificates.

Tom Feys ¹¹⁰ in his article '*The context of Globalization*' argues that international investors are only interested in own profits and are not interested in the well-being of a country's citizens and the fact of the matter is that globalization has its winners and its losers. He stresses the importance of a formal harmonization of labour standards in the Southern African region. There seems to be some merits in this argument and the JSE should take cognisance of this occurrence. Harmonization of standards with other African Stock Exchanges would be necessary in order to benefit of globalization. In order for the JSE to attract foreign investment it first has to pay attention to attracting local investors. South Africa's wealth is its people and their inherent potential to transform our economy into a global one.

¹¹⁰ Tom Feys 'The need for a common approach - the context of Globalization' *ILJ* 1445

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