JSE

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Hon. J Maswanganyi,

Chairperson: Standing Committee on Finance (National Assembly)

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Dear Honorable Chairperson

COMMENTS ON THE ON THE 2021 DRAFT TAX BILLS

The JSE welcomes the opportunity to comment on the 2021 Draft Tax Bills. Our submission to the Standing Committee of Finance sets out the exact comments we submitted to National Treasury and SARS. Our comments are limited to Paragraph 56 of the Draft Tax Amendment Bill (TLAB), which proposes an amendment to the definition of *'collateral arrangement'* in Section 1 of the Securities Transfer Tax Act, 2007 ('the proposed amendment').

We recognise and support the need for the government's ability to identify and sanction the improper use of collateral, which results in the avoidance of securities transfer tax or income tax (including capital gains tax). However, the JSE is of the view the legislative framework and market convention adequately prevents the improper use of collateral, and that the proposed approach of limiting the re-use of securities received as collateral through a tax-neutral collateral arrangement will have a material negative impact on the liquidity, stability and attractiveness of the South African capital markets. We note also that the definition of 'collateral arrangement' already includes an anti-avoidance provision.

A vibrant and liquid capital market is essential to the stability and indeed the attractiveness as an investment destination; a liquid market is generally associated with less risk, as it provides investors with confidence that they can sell securities relatively quickly at a fair price, without affecting the market price of the security. Non-cash collateral (listed bonds and equities) provided by a collateral giver in respect of a debt or a margining obligation frees up cash to be used for other market activities (i.e. trading), thereby increasing market liquidity.

South Africa's macro environment has deteriorated over the past five years and last year, all three global rating agencies lowered their ratings of South African sovereign's credit standing. As result, South Africa has either exited key global indices or become severely diluted. The effect of this negative macro environment has been significant net outflows in trading by foreigners in South African bonds and equities. It is our view that limiting the re-use of collateral will lead to a significant decline in liquidity in the South African capital markets, the diminished attractiveness of South Africa as an investment destination and further capital outflows.

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Default of a collateral giver

In both cases of a debt or margining obligation, collateral is taken by a collateral taker as security against the potential default of the collateral giver. The collateral taker must be able to sell (re-use) the securities in the event of a default of the collateral giver, without the collateral arrangement disqualifying for relevant tax exemptions. Although the proposed the insertion in subsection (1) in the definition of 'collateral arrangement' (cA) provides for listed securities held as collateral may be used for the *'purposes of providing security'*, it does not explicitly provide for the re-use or disposal of the securities in the event of a default of the collateral giver. This omission negates the rationale for a tax-neutral collateral arrangement, and if not qualified would lead to less credit extension and derivative activity in the South African financial markets.

Re-use of collateral

As noted above, the provision of non-cash collateral improves the liquidity of a market. The re-use of collateral significantly improves the liquidity of the market and increases activities in the market which attract tax. A limitation on the re-use of collateral would materially erode liquidity and reduce taxable activities. Collateral takers are required to return identical securities to the collateral giver at maturity of the collateral arrangement, and if the collateral taker has re-used the collateral provided, the collateral taker will be required to purchase those identical securities in the market, attracting tax consequences (income tax and both income tax and securities transfer tax on a share). The initial re-use of collateral (i.e. sale of securities) also attracts tax consequences.

There a number of activities in the market arising out the re-use of collateral which would be affected by the proposed amendment and which would have far-reaching consequences on the efficient operation of the markets. Of most concern is the impact the proposed amendment would have on the repo market and the liquidity of the secondary bond market. A reduction of liquidity in the secondary bond market would negatively impact the primary market and would weaken the demand for sovereign debt or corporate debt instruments. The repo market serves as a mechanism for commercial banks enabling the transfer of primarily sovereign bonds (including the re-use of collateral) to the SARB for liquidity. A disruption of the repo market could result in liquidity issues for the banking sector, and consequently the stability of the financial markets.

Proposed effective date

The retrospective effective date of the proposed amendment would in essence disqualify all collateral arrangements entered into on or after 28 July 2021 from the favourable and legitimate tax treatment, even if the collateral taker does not 're-use' the collateral, as insufficient time has been provided for collateral takers and collateral givers to amend their agreements. We strongly recommend that, if the proposed amendment is introduced in its current form, a transition period must be provided for, to enable sufficient time for the amendment of collateral agreements.

The JSE believes that the proposed amendment effectively reverses the benefits identified when the tax dispensation for an outright transfer of collateral was introduced. The benefits identified included – (i) assistance to the financial sector industry in meeting regulatory changes and demands; (ii) increase in availability of high quality liquid assets which directly increases market liquidity; (iii) reduction of transaction costs and market pricing because of the ability to re-hypothecate collateral and reduce tax costs; and (iv) making South Africa more attractive as an investment destination.[1] We respectfully submit that National Treasury and SARS reconsiders the proposed amendment and finds an appropriate legislative or regulatory measure to address improper use of collateral - a measure that does not adversely affect the liquidity, stability and attractiveness of the South African capital and financial markets.

The JSE stands ready to provide any information or clarification of our submitted comments.

Yours sincerely

Anne Clayton

Head: Public Policy & Regulatory Affairs

[1]http://www.treasury.gov.za/legislation/bills/2015/Explanatory%20Memorandum%20on%20the%20Taxation%20Laws%20Amendment%20Bill%2029B%20of%202015.pdf