

FSCA COMMUNICATION 36 OF 2022 (CIS)

Exemption of Managers of Collective Investment Schemes from Certain Requirements in Board Notice 90 of 2014

1. PURPOSE

The purpose of this Communication is to inform stakeholders that today, the Financial Sector Conduct Authority (FSCA) published, in terms of section 22 of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002) (CISCA), read with section 281(3)(b) of the Financial Sector Regulation Act, 2017 (No. 9 of 2017), FSCA CIS Notice 7 of 2022 - Exemption of Managers of Collective Investment Schemes from Certain Requirements in Board Notice 90 of 2014.

2. BACKGROUND AND CONTEXT

- 2.1 Currently Exchange Traded Funds (ETFs) are listed on the exchanges, particularly the Johannesburg Stock Exchange (JSE), in the following two main categories:
- (a) ETFs that comply with the regulatory framework applicable to collective investment schemes (CIS) and which are registered as CIS portfolios under registered CIS ETF Schemes (CIS ETFs); and
 - (b) ETFs that are not required to comply with CIS laws, but with other rules prescribed by the JSE, for example commodity type funds, such as Gold ETFs or Platinum ETFs, which are not under discussion herein.
- 2.2 When ETFs were introduced in South Africa, the JSE restricted CIS ETFs to passive funds, i.e. portfolios that must track a chosen index. Consequently, the FSCA only approved investment by CISs in index tracking CIS ETFs and not also investment in other types of CIS ETFs.
- 2.3 Therefore, the “*Determination of securities, classes of securities, assets or classes of assets that may be included in a portfolio of a collective investment scheme in securities and the manner in which and the limits and conditions subject to which securities or assets may be so included*”, published under Board Notice 90 of 2014 in *Government Gazette* No. 37895 on 8 August 2014 (BN 90), currently only permits investment by CIS portfolios in physical ETFs. In this regard, BN 90 defines “*physical exchange traded fund*” as “*an exchange traded fund which tracks an index or the value of precious metals and which physically holds the underlying assets it is tracking;*”.

3. POLICY STATEMENT - ALLOWING ACTIVELY MANAGED CIS ETFs

- 3.1 Internationally, actively managed pooled funds are commonly listed and there is significant demand for actively managed CIS ETFs in particular.¹ Certain investors view an exchange as the preferred investment channel as it is trusted, provides a single platform offering a wide spectrum of investments and provides immediate liquidity.
- 3.2 In addition, previously the JSE engaged the FSCA with a proposal to amend the JSE Listing Requirements to pave the way for issuers to list and trade actively managed ETFs for the first time.
- 3.3 Taking into consideration, amongst other things, international developments and the proposal put forward by the JSE, the FSCA is of the view that the introduction of actively managed ETFs will suitably assist in expanding the universe of CIS portfolios and therefore the investment universe for investors. ETFs, as they exist currently, have performed well as an investment channel in SA and internationally.
- 3.4 At this stage there are no obvious concerns regarding the introduction of actively managed ETFs as an additional permitted security. Actively managed ETFs will be operated and managed in the same manner as the current index tracking ETFs, it is only the investment mandate which differs.
- 3.5 The benefit of an actively managed ETF is that it is not compelled to be fully invested nor must it buy derivatives to ensure investments are equal to the tracking of an index; thus it can hold more assets in liquid form, providing for more redemption liquidity in the portfolio.
- 3.6 The FSCA therefore supports creating an enabling environment for the establishment of, and investment into, actively managed CIS ETFs.
- 3.7 As such, the FSCA approved amendments to the JSE Listing Requirements that will allow issuers to list and trade actively managed ETFs, subject to various requirements, and these amendments came into effect on 14 October 2022.

¹ Examples of international providers of listed actively managed funds include: WCM/BNY Mellon, Blackrock iShares, Invesco, Guggenheim/Claymore, Pimco, Advisorshares, etc. in the USA; Fidelity etc. in Luxembourg; and Franklin Templeton and, JP Morgan, etc. in the UK. The value traded of active ETFs on the London Stock Exchange has risen substantially from £578m in 2016 to over £110bn for the current 2022 year to date.

- 3.8 It is also the FSCA's intention to make targeted amendments to BN 90 to, amongst other things, allow CISs to invest in actively managed ETFs. In addition, as a longer-term project the FSCA in conjunction with the Prudential Authority will undertake a holistic review of BN 90. Both of these processes will, however, take time.
- 3.9 The introduction of actively managed ETFs does not deviate from current investment fund and CIS policy, it merely expands the current narrow mandate of ETFs to permit portfolios that are already provided for in the traditional CIS space. The FSCA is also of the view that any potential risks may be suitably mitigated.
- 3.10 The FSCA therefore proposes that investment by CISs into actively managed ETFs should be permitted at this time, pending further refinements to the framework that will be given effect to through the amendment and review of BN90.
- 3.11 The FSCA is of the view that to facilitate such, an exemption of CIS managers from certain requirements in BN90 can produce the most appropriate interim solution, pending the holistic review of BN 90. Accordingly, the FSCA has published a notice exempting CISs from the requirements set out in paragraphs 3(3)(a)(v) and 3(14)(b) of BN 90, with a view to promote financial markets, market entry and market participation.
- 3.12 Conditions have been imposed in the Exemption to ensure that investors are afforded the necessary protection, including: disclosure of its difference to index tracking funds and exclusion of synthetic derivatives.
- 3.13 To further mitigate potential risk, it might be noted that the JSE Guarantee Fund (the Fund) provides protection to investors, up to certain limits, in the event of a JSE member's default in the settlement of the shares of an ETF listed on the JSE and the investor being unable to recover the shares or funds held by the member on their behalf. Following the default of a member firm, the Fund will consider an investor's claim and pay out that claim, should it be deemed to qualify. The Fund would then claim against the residual assets of the member firm. The JSE also holds fidelity insurance for its member firms.
- 3.14 The listing of actively managed CIS portfolios may create an additional layer of investor protection and security by virtue of the JSE's supervision of the product and its involved members, in addition to the FSCA supervision.
- 3.15 The frequent intraday trading of the fund will also aid in price discovery of its shares.

3.16 It should further be noted that actively managed CIS portfolios still need to comply with all the relevant CIS legislation. Other aspects in current legislation that are impacted, for example the pro forma wording for Supplemental Deeds for ETFs that require the tracking of an index and the alignment of relevant JSE rules, have been considered and changes will be proposed in due course.

4 AVAILABILITY OF INFORMATION AND ENQUIRIES

4.1 The Exemption is available on the FSCA's website at www.fsca.co.za.

4.2 For more information regarding the Exemption and/or this Communication, please contact the Regulatory Frameworks Department of the Authority at marius.dejongh@fsca.co.za.



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