

# Supervisory Framework

**strate**

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Version 1	July 2023	Pheona Härtel, Thabile Omoighe, Strate Supervision Division	Introduction of a framework that structures how the Strate Supervisory Division is set up and how it will discharge its supervisory activities. Included in the framework is the management of conflicts of interest between Strate's regulatory function and its commercial activities and the management of confidential information obtained by Strate Supervision in the performance of its supervisory and enforcement functions.

# 1. Introduction

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## 1.1 Purpose of the document

The purpose of this document is to provide parties with a reference and explanation of the supervisory, investigative and enforcement functions performed by Strate Supervision.

## 1.2 Public disclosure

The document is the property of Strate Supervision and is publicly available online at [www.strate.co.za](http://www.strate.co.za)

# 2. Why does Strate perform a regulatory and supervisory function?

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## 2.1 Legal basis

Strate (Pty) Ltd (Strate) is licensed as a central securities depository (CSD) providing post-trade products and services to the South African financial markets. Strate is licensed and regulated by the Financial Sector Conduct Authority (FSCA) in accordance with the Financial Markets Act (No 19 of 2012) (FMA).

In accordance with sections 30(2)(d), 30(2)(g) and 30(2)(i) of the FMA, Strate has been mandated to issue, supervise compliance with and enforce the Strate Rules and Strate Directives. The Strate Risk, Legal and Compliance Division is responsible for establishing and maintaining the regulatory framework within which the CSD, Participants, clients and issuers operate, in accordance with the FMA.

Once the Strate Rules and Strate Directives have been approved, Strate Supervision assumes the function of supervising compliance with same. This separation between the regulatory and supervisory functions of Strate and its operational functions as a CSD aligns with Strate's duty in terms of section 62 of the FMA to take the necessary steps to avoid, eliminate, disclose and otherwise manage possible conflicts of interests between its supervisory functions and its commercial activities.

As an authorised CSD, Strate fulfils a role as a self-regulatory organisation (SRO) in accordance with the FMA. It is through, *inter alia*, section 2 and 3 of the Strate Rules that the powers to regulate and supervise are vested in Strate.

In terms of the Strate Rules:

*"2.4 The authority to make and enforce the Strate Rules and Strate Directives vests in the Strate Board of Directors, which authority has been delegated to the Regulatory and Supervisory Committee.*

*2.5 The Regulatory and Supervisory Committee may impose a penalty or take disciplinary action against any person referred to in section 35(6) of the Act, which fails to execute an instruction given or take any action required by the Strate Board of Directors in accordance with the Strate Rules and Strate Directives.*

...

*2.7 The Regulatory and Supervisory Committee must make, and may amend, Strate Rules that comply with section 35(6) of the Act and must supervise compliance with the Strate Rules by Participants."*

In terms of section 31 of the FMA, a CSD must make arrangements for the proper supervision of compliance by CSD Participants with the Strate Rules. The Strate Board of Directors has delegated this obligation to a Committee of the Strate Board of Directors, namely the Strate Regulatory and Supervisory Committee (the Committee).

The FSCA has oversight responsibility of Strate's regulatory, supervisory, investigative and enforcement activities. It acts as an observer on the Strate Board and Board Committees and constantly monitors the CSD's activities and actions. Failure by Strate to adhere to the FMA and further the objectives of the FMA, may result in the non-renewal, suspension or withdrawal of its licences or the imposition of conditions on the licences.

## 2.2 Strate's role as a self-regulatory organisation (SRO)

The current regulatory model adopted in South Africa, with regards to the financial markets, supports the use of self-regulatory organisations. In terms of section 30 of the FMA, the FSCA delegates the regulation and supervision of CSD Participants to the CSD. As a result of its authorisation as a CSD, Strate regulates and supervises its Participants.

A self-regulatory organisation has the following characteristics:

- It is an independent body, i.e. independent of government and of specific interest groups, and has its own decision-making function;
- It has practical responsibility for regulating the industry;
- It has the power to enforce its decisions;
- It can rely on sufficient support from the constituent parts of the securities industry to ensure its credibility, i.e. the moral and practical support of the securities industry;
- It is impartial;
- It is enabled to deal with complaints; and
- Its decision-making processes and adjudications are transparent.

The advantages of self-regulatory organisations include:

- Regulation is carried out by acknowledged experts in the market;
- The regulators' standing in the market is likely to enhance the consent and compliance of the regulated;
- The SRO is fully aware of innovations and industry changes and their implications, and can adapt accordingly;
- The SRO is likely to be less legalistic and dogmatic in its decisions;
- It is in the self-interest of the SRO to maintain standards and retain the public's confidence in the market;
- The SRO is better positioned to detect abuses of the regulatory system;
- The SRO can operate with greater flexibility, speed and effectiveness than direct regulation; and
- Self-regulation is more effective as the regulated activity becomes more specialised.

## 2.3 The Committee:

The Committee, which is a committee of the Strate Board of Directors, is tasked with the overall objective of assisting the Strate Board of Directors in discharging its regulatory, supervisory, investigative and enforcement obligations in terms of the FMA, the Strate Rules and Strate Directives.

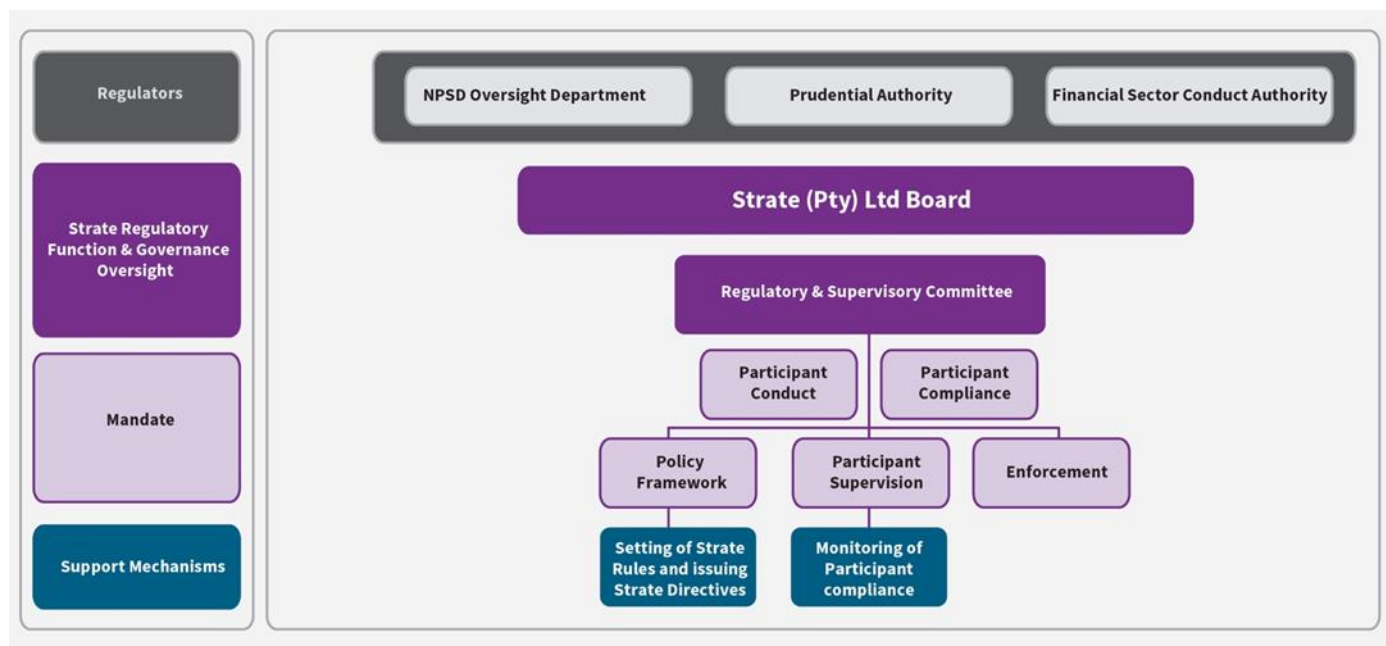
The Committee is mandated to manage, oversee and execute on Strate's regulatory and supervisory functions. These functions include a Rule and Directive setting function, the supervision and compliance enforcement of Participants' obligations, and

assisting with the preservation of confidence in the South African financial markets by collaborating on the identification and management of systemic risk.

The Committee is supported operationally by the Strate Supervision Division and the Legal Risk and Compliance Division in their respective regulatory, supervisory, investigative and enforcement activities.

The activities of the Committee are governed by a documented Terms of Reference, aligned with both the FMA and the Strate Rules. The diagram below depicts the governance and regulatory structures in relation to the Committee.

Please refer to the Strate website [www.strate.co.za](http://www.strate.co.za) for a copy of the Committee’s Terms of Reference



Committee composition:

- The Committee must comprise of a minimum of three (3) independent non-executive directors of the Board. The members are appointed by the Board. The members must collectively have sufficient qualifications and experience to fulfil their duties.
- The Board must appoint the Chairperson of the Committee (Chairperson) and determine the period and terms for which he or she will hold office. The Board Chairperson shall not be eligible to be appointed as Chairperson of the Committee.

Invited observers include representatives of the FSCA and Strate's CEO.

## 2.4 Strate Supervision:

The appointment of Strate as an SRO necessitated the establishment of the Strate Supervision Division.

The Strate Board of Directors ensures that the supervision division is a separate division within Strate and overseen by the Head of Supervision.

Strate Supervision maintains systems for monitoring compliance by Participants, officers, employees and agents of the Participants with the provisions of the Strate Rules and Strate Directives, as well as the surveillance and enforcement of any matter relevant for the purposes of the Strate Rules and Strate Directives.

Performance appraisals of the head of Strate Supervision are conducted by the Chairperson in conjunction with the CEO of Strate. The head of Strate Supervision conducts the performance appraisals of Strate Supervision employees. As stated above, this division is accountable to the Committee for the supervisory, investigative and enforcement functions and reporting to the Committee and the FSCA on each Participant's compliance with the FMA, Strate Rules and Strate Directives.

Appropriate measures to manage conflicts of interest between Strate's commercial (CSD) functions and its SRO (regulatory and supervisory) functions have been established. Strate Supervision employees are also constantly reminded of their duty to observe the highest professional standards and are given clear guidance on the avoidance of conflicts of interest, the possible abuses of confidential information, the observance of confidentiality and secrecy and the observance of procedural fairness.

## 2.4.1 Funding of Strate Supervision's supervisory, investigative and enforcement activities

### 2.4.1.1 Annual participation and application fee

In terms of the FMA, the CSD must ensure it has set up and maintains systems for monitoring compliance by Participants with the FMA, Strate Rules and Strate Directives. This annual fee is payable per market in which the Participant is authorised to perform Participant-related services, and covers the costs of the supervision, investigative and enforcement functions performed by Strate Supervision.

Revenue is also allocated to the division when a new entity applies for approval as a Participant. This fee is charged for the consideration of an application for participation. The fee is payable by an applicant before they may be authorised as a Participant in terms of the Strate Rules. This is a once-off (non-refundable) "approval fee" and is payable by the applicant in respect of each market it intends operating in.

In addition to the above, a percentage of all settlement fees is allocated to Strate Supervision. This "supervisory levy" is also used to cover the costs of monitoring compliance by Participants.

### 2.4.1.2 Special Purpose Reserve Fund - Fines

Section 71(6)(a) of the FMA allows the CSD to impose penalties on its Participants for contraventions of the FMA, Strate Rules or Directives. The primary sanctions imposed on Participants are monetary fines.

CSD Rule 12.14 states that *"Any fine paid to Strate pursuant to a ruling made in terms of the Strate Rules must be used to further the objectives of the South African financial markets as determined by the Strate Board of Directors, for fundings or subsidising;*

*12.14.1 the costs of relevant education, training and/or examinations provided generally for the benefit of market participants, investors and other external stakeholders;*

*12.14.2 projects which would further the objectives of the Act and promote adherence to international best practices within the financial markets, excluding any costs associated with Strate's Business."*

As such, funds collected through the imposition of monetary fines are allocated to a Special Purpose Reserve Fund (SPRF) and are not used to subsidise the costs or operational functions of Strate or Strate Supervision. All the funds generated from fines imposed on Participants and business partners are accounted for separately in Strate's financial records. The SPRF is used to



fund or subsidise special projects or market training initiatives and this funding requires the prior approval of the Strate Audit and Risk Committee (ARC).

Income or funds collected through fines are not classified as a standard revenue item and are not budgeted for.

## 2.5 Supervisory risks

Strate Supervision strives to build fair and credible supervisory processes consistent with low-to-medium intensity supervision. The division aims to consistently apply and enforce its risk-based, supervisory approach.

In this context, Strate Supervision continues to ensure that adequate oversight and monitoring controls are deployed to mitigate the specific risks which the division does, or can, confront. The division aligns itself with the wider Strate risk methodology – completing quarterly risk matrix exercises and comprehensive risk reporting to the Committee. The Committee continually monitors and reviews the Supervision division's risk management programmes, systems and performance, and reports this to the ARC on an ongoing basis.

Participants are also required to maintain adequate systems of internal control to manage and mitigate the risks that they face. The two broad categories of risks monitored by the division in respect of Participants are operational risk and financial risk.

Operational risks can be divided into several sub-risks which are detailed below:

- Custody risk - The risk of loss of securities held in custody occasioned by the negligent or fraudulent action of the Participant. The risk of incorrect record keeping by the Participant, and as a result the investor suffers a loss or it undermines confidence in the efficiency and effectiveness of the market.
- Technology and systems risk - This risk relates to the inability of the custody and payment systems/applications to manage and/or control the business processes/information of the Participant. The risk of system failure or technical difficulty experienced by a Participant, which results in the entity being unable to perform its CSD-related activities.
- Communication risk - The risk that the exchange of information between Participants and Strate, and Participants and their clients, is inadequate. The risk that the Participant (and as such its clients) is not aware of or misunderstands new/amendments to operational procedures, Strate Rules and Strate Directives. This results in operational errors and as a consequence the investor suffers a loss or it undermines confidence in the efficiency and effectiveness of the market.
- Contractual or legal risk - The risk that the Participant acts without, or contrary to the provisions of, a client mandate. The risk that the Participant settles transactions over a client's Securities Account without there being a mandate in place, or alternatively, where a mandate is in place, acts contrary to the binding terms and conditions. As a result, the investor suffers a loss or it undermines confidence in the efficiency and effectiveness of the market.
- Compliance officer risk - The risk that the Strate compliance officer is not effective in monitoring the applicable processes and procedures. The risk that the Strate compliance officer fails to perform the roles and responsibilities prescribed in the Strate Rules, which could result in fraud and errors in the custody and settlement records maintained by the Participant not being detected. This could result in the investor suffering a loss or it undermines confidence in the efficiency and effectiveness of the market.
- Project management risk - The risk that the implementation of new or amended Strate product or functionality fails or cannot be implemented timeously due to lack of resources or poor project management, and this introduces risk to the Participant, CSD, exchanges or other stakeholders.
- Human resources or personnel risk - The risk that a Participant fails to recruit or retain qualified staff with appropriate skills and competencies to perform each business function.
- Audit risk - The risk that the auditors (internal and registered) lack the knowledge and experience of Strate procedures and practices, which results in inadequate audit findings. The risk that the auditors lack the knowledge and experience

of Strate-related activities, which results in them failing to detect errors, weaknesses and transgressions, leading to poor or unreliable audit reports.

Prudential risks can be separated into two separate risks, namely:

- Insurance risk - The risk that the Participant has inadequate insurance in place to operate as a risk-mitigating tool. The risk that in the event of a loss (either own or via claim from third party) the Participant cannot look to an insurer or lacks sufficient reserves (in the event of self-insurance) to cover the financial costs or damages arising from the event.
- Financial risk - The risk that the Participant cannot continue to operate as a financially viable entity. The risk that the Participant fails (insolvent, placed into curatorship or business rescue) and the assets (both cash and securities) are trapped in the failed entity to the detriment of the client.

### 3. Who is Strate Supervision responsible for supervising

In terms of the FMA, Strate Supervision is only responsible for the supervision of Participants. This supervisory obligation does not extend to the activities of the various exchanges, their members or brokers, or other entities such as transfer secretaries, pension funds or hedge funds operating in the securities industry.

Strate Supervision is concerned primarily with ensuring Participant adherence to and compliance with the FMA, Strate Rules and Strate Directives.

The Participants approved to hold equities (E), bonds (B) and money market (MM) securities in the CSD are:

<b>Entity</b>	<b>Approved to operate in the following markets:</b>
1. Absa Bank Limited	E, B and MM
2. Citibank N.A - South African Branch	E, B and MM
3. Computershare Proprietary Limited	E
4. FirstRand Bank Limited	E, B and MM
5. JSE Investor Services PARTICIPANT Proprietary Limited	E
6. Nedbank Limited	E, B and MM
7. The Standard Bank of South Africa Limited	E, B and MM
8. South African Reserve Bank (SARB)	B and MM
9. Standard Chartered Bank - Johannesburg Branch	E, B and MM

## 4. What activities does Strate Supervision supervise

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### 4.1 Aspects of the Strate Rules and Strate Directives which require monitoring

The sections of the Strate Rules and Strate Directives which Strate Supervision focuses its supervisory and enforcement attention on, and aspects which require monitoring are those that deal with, *inter alia*:

- Knowledge and skill of the employees of the Participant who have access to or input data into the CSD systems or who provide information to those people who input data into settlement systems;
- Continued adherence to the participation eligibility criteria;
- System capability and DR/BCP requirements;
- Record keeping and the maintenance of Securities Accounts and Central Securities Accounts;
- Reconciliation (balancing) of Securities Accounts and Central Securities Accounts;
- Adherence to the financial soundness provisions (capital adequacy) – in respect of non-bank Participants;
- Adherence to the settlement parameters and timeframes;
- Adherence to the corporate actions parameters and timeframes;
- Accuracy and completeness of beneficial ownership information and disclosure;
- Approval of Participants and their nominees; and
- The recognition of FSCA-approved nominees.

## 5. Legal framework

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### 5.1 The regulatory structure (Twin-Peaks Model)

The primary regulatory legislation for the South African financial sector is the Financial Sector Regulation Act (No 9 of 2017) (FSRA), known informally as “Twin-Peaks” legislation. Its main goals include:

- Financial stability;
- The safety and soundness of financial institutions;
- The fair treatment and protection of financial customers;
- Efficiency and integrity of the financial system;
- Prevention of financial crime;
- Financial inclusion;
- Financial sector transformation; and
- Confidence in the financial system.

The two main regulatory bodies (or “twin peaks”), are:

- The FSCA, formerly known as the Financial Services Board (FSB), responsible for conduct regulation in the financial sector; and
- The Prudential Authority (PA), formerly known as the Bank Supervision Division of the South African Reserve Bank, responsible for prudential regulation in the financial sector.

The effect of the FSRA framework is that Strate is regulated by both regulatory bodies, namely the FSCA (for conduct) and the PA (for prudential aspects). The two regulatory bodies issue standards (sometimes jointly) that must be adhered to by regulated entities, including Strate.

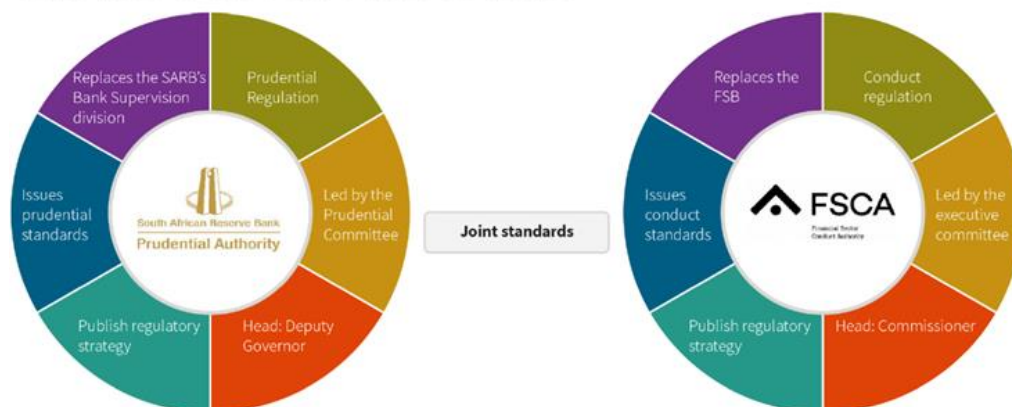
The FSRA gives the SARB the mandate to manage financial sector stability. It also gives the Governor of SARB the power to determine, in consultation with the Minister of Finance, systemic events that could have a substantially adverse effect on the financial system or economic activities in South Africa.

The FSRA also establishes:

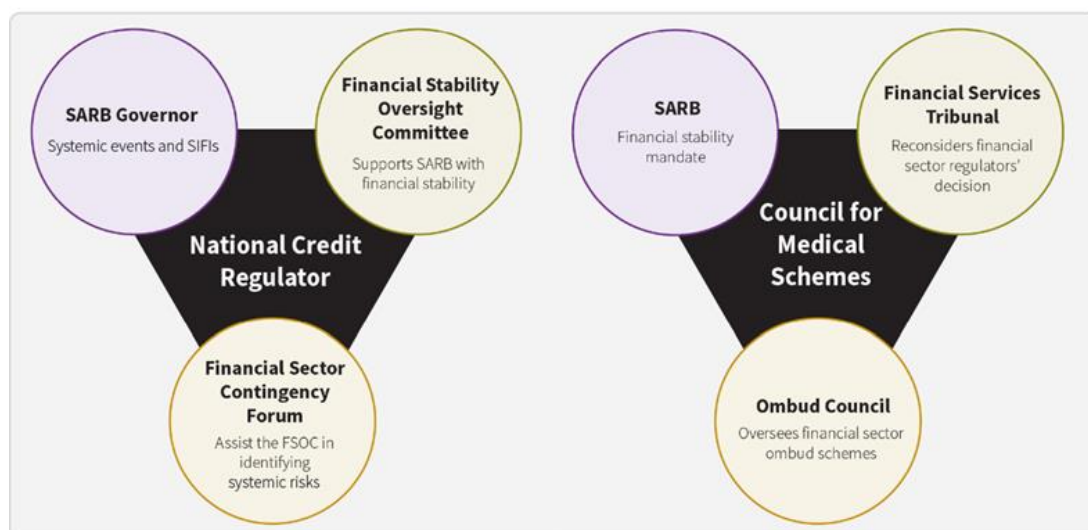
- The Financial Services Tribunal, which reviews the decisions of regulatory bodies, including the FSCA, PA and Strate; and
- The Ombud Council, which oversees ombud schemes in the financial sector.

The following diagram summarises the regulatory structures under the FSRA:

## THE REGULATORY STRUCTURES



## OTHER ROLE-PLAYERS



## 5.2 Financial Markets Act (FMA)

The FMA sets out the legal framework within which Strate conducts its CSD business. This legal framework supports both the operational and regulatory functions of Strate as a CSD. The regulatory powers of Strate under the FMA entail the issuance of monitoring compliance with, and enforcement of, the Strate Rules and Directives. Strate has the power to authorise and regulate Participants in accordance with the legislative principles set out in the FMA. The FMA's objectives are to:

- Ensure that the South African financial markets are fair, efficient and transparent;
- Increase confidence in the South African financial markets by requiring that securities services be provided in a fair, efficient and transparent manner, and contributing to the maintenance of a stable financial market environment;
- Promote the protection of regulated persons, clients and investors;
- Reduce systemic risk; and
- Promote the international and domestic competitiveness of the South African financial markets and of securities services in the Republic.

The FMA applies to "regulated persons" (i.e. Strate, Participants, exchanges, authorised users etc.) and the securities services they provide. CSDs and exchanges are also granted certain powers to regulate participants and authorised users, respectively. This is known as a "self-regulatory" or "co-regulatory" regime. Strate, as an SRO, regulates Participants in accordance with the requirements prescribed in the FMA, while the FSCA oversees Strate's regulatory functions. The FSCA's regulatory oversight over Strate ensures that Strate meets the objects of the FMA when conducting its CSD business.

In terms of the FMA, Strate must act with due regard to the rights of Participants and their clients, and issuers. To ensure adequate disclosure and transparency, the FMA states that Strate must disclose its fees and charges to Participants and issuers, and provide in its rules for equitable criteria for the acceptance and expulsion of a Participant.

## 5.3 Strate Rules and Strate Directives

A comprehensive set of Strate Rules has been created to:

- Ensure that Strate is managed and controlled by a competent body with the necessary powers to effectively manage the CSD;
- Ensure that participation in Strate is limited to suitable entities that comply with entry criteria;
- Ensure that Strate's business and that of Participants is carried out according to a strict ethical code, with a disciplinary procedure to deal with contraventions of the code or the Strate Rules;
- Prescribe the various types of accounts that clients may hold with a Participant, and that Participants may hold with Strate; and
- Prescribe security measures and internal and external controls that Participants must uphold.

While the FMA sets out a framework for market regulation, it leaves much of the detailed substantive provisions to the rules and directives issued by market infrastructures such as Strate. Strate Rules and Strate Directives must be consistent with the FMA. The FMA prescribes how Strate must make its rules. Strate must issue rules and directives in accordance with a fair, consultative process, engaging with Participants and other affected stakeholders such as issuers and exchanges, where required.

This consultative process ensures affected parties are given a reasonable opportunity to comment. Strate's legal function is responsible for writing and amending Strate Rules and Strate Directives. Issuing or amending Strate Rules or Strate Directives is a process that can be initiated by Strate, a Participant, issuer, or any other affected person. Strate Directives are reviewed

by the Committee, while the FSCA approves Strate Rules. The FSCA publishes Strate Rules in the Government Gazette for public comment before final approval.

## 6. How does Strate Supervision perform its supervisory, investigative and enforcement functions

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Supervision and monitoring includes, *inter alia*, the following elements:

- Specific regulations governing the activities of Participants which need to be monitored;
- Robust entry (participation eligibility) criteria;
- Disciplinary procedures; and
- On-site inspections or reviews.

Strate Supervision's supervisory, investigative and enforcement strategy is about optimising the combination of these components. All components are necessary as none alone is sufficient. The mix will change over time and, depending on transgressions, heavier reliance may be placed on particular components than others.

Precise regulatory and legislative requirements have been laid down that are applied uniformly to all Participants. In terms of this, a clear set of objectives have been laid down and each Participant must be able to demonstrate how these objectives are to be met by its own internal procedures. The Participant has to meet agreed standards and procedures and, if not, Strate Supervision can act in terms of the disciplinary procedures as detailed in the Strate Rules.

"Supervisory intensity" refers to the degree of detail and prescription and the extent to which the behaviour of the regulated person has to be modified by the regulatory agency or regulator. The supervision of Participants normally entails medium- to high-intensity supervision – or high in some instances, e.g. acceptance procedure of Participants, with low intensity supervision that escalates whenever needed. This combination has proven suitable for the South African market.

### 6.1 Supervisory, investigative and enforcement tools

Strate Supervision utilises a number of tools (sources of information) to identify, manage and mitigate against the various supervisory risks. Three core sources of information have been identified, namely:

- Information sourced from within Strate's settlement systems and obtained from interaction with Strate's internal divisions (e.g. Strate Settlement, IT and Corporate Actions);
- Information acquired from the CSD Participant itself (e.g. compliance officer reports); and
- Information obtained from third parties (e.g. registered auditors, exchanges).

A brief explanation of the key tools utilised by the Strate Supervision is provided below:

#### 6.1.1 Exception reports

Numerous settlements-related exception reports are generated from Strate's systems (equities, bonds and money markets) and are reviewed on a daily, weekly or monthly basis (as required) to identify non-adherence to a variety of Strate Directives.

### 6.1.2 Monetary fines database/Fines statistics

Strate has issued a number of Fine Directives that detail the settlement-related actions or activities on the part of Participants, which constitute a transgression, and the associated monetary fine which may be imposed by Strate Supervision for such conduct.

Strate Supervision maintains a database of all fines imposed on Participants and business partners. Fine statistics are closely monitored and reported quarterly to the Committee and one-on-one discussions to address any concerns regarding any perceived lack of internal controls may be held with a Participant, if deemed necessary.

Strate Supervision is only empowered to impose fines as stipulated in the applicable Fines Directive. Any transgression for which no fine exists must be referred to the Committee for consideration. The Committee will determine the appropriate fine quantum, if any, to be imposed on a Participant for a breach of the FMA, Strate Rules or Strate Directives.

In terms of section 71(6) of the FMA, a market infrastructure may impose any one or more of the following penalties for any contravention or failure to comply with its rules:

- A reprimand;
- A censure;
- A fine not exceeding R7.5 million;
- Suspension or cancellation of the right to be a Participant;
- Disqualification, in the case of a natural person, from holding the office of a director or officer of a Participant, for a period of time;
- A restriction on the manner in which a Participant may conduct business or may utilise an officer, employee or agent;
- Suspension or cancellation of the authorisation of an officer or employee of a Participant to perform a function in terms of the rules; and
- Any other penalty that is appropriate in the circumstances.

### 6.1.3 Internal and external stakeholder liaison

This includes daily communication and interaction with, for example, Strate Settlement and the various exchanges on issues such as technical difficulties, special approvals, extensions to operational timelines etc. Information gleaned from other Strate internal divisions and external parties about the operational performance of Participants is also taken into account.

The formalised mechanism for the sharing of information between Strate Supervision and other divisions within Strate is through the signing of Service Level Agreements (SLAs). These agreements clearly define the scope, nature and format of information, specific to each Strate division, which should be divulged and shared.

There are no confidentiality barriers in respect of Strate sharing information with Strate Supervision where a Participant is believed to be contravening the FMA, Strate Rules and Strate Directives or introducing risk into the market.

Where Strate Supervision becomes aware of information concerning a Participant that is having an operational problem that could impact on, or introduce systemic risk to the CSD functions of Strate, this may be passed on to the relevant operational divisions within Strate, subject to the processes set out in sections 7 and 8 of this Framework.

An annual exercise is conducted to review the accuracy of all SLAs in place with the various Strate divisions.

#### 6.1.4 Relationships with co-regulators – formalised through the use of Memoranda of Understanding (MOUs)

Monitoring the securities industry requires a highly coordinated effort and that the applicable regulatory authorities collectively enforce the securities laws to promote stability in the markets, reduce systemic risk and most importantly, to protect investors.

MOUs serve as the agreements by which regulatory and compliance information pertaining to relevant regulated entities is shared between securities regulators in order to avoid duplicating regulation or over-regulating the market.

#### 6.1.5 Participants & business partner technical difficulty database

Strate Supervision recognises that every organisation can experience an incident that could prevent it from continuing normal business operations at any time. As such, those responsible for the management of the entity have a duty to ensure the organisation can recover from such instances in the minimum amount of time possible.

Participants and business partners are required to notify Strate Settlement and Strate Supervision of technical difficulties within 30 minutes of identifying such an incident. Hourly updates on the status of the difficulty must also be provided until resolution.

A formal “technical difficulty log” must be completed by the affected entity and provide details such as:

- The time the issue was identified and ultimately resolved;
- The time the difficulty arose;
- The severity of the difficulty;
- The specific market and systems impacted by the difficulty;
- Whether any extensions to operational windows will be required.

Strate Supervision maintains a detailed database of all difficulties reported by Participants and closely monitors the number of difficulties experienced in a given period, the average system “down time” and the severity of incidents being reported. A high frequency of system difficulties (over a prolonged period of time) would normally result in the division raising concerns regarding the Participant’s technical capabilities with the entity’s senior management. Participants will usually be required to provide details of the steps they intend to take to reduce the number of difficulties being experienced. The root cause of the incident, together with a remediation plan to address the root cause, must be provided, in writing, within fifteen (15) business days of disruption, or upon any extended timeframe as permitted by Strate Supervision.

#### 6.1.6 Disaster recovery/BCP database

In terms of Strate Rule 8.1.8, all Participants are required to conduct a full disaster recovery test bi-annually on their relevant internal systems and related infrastructure, and report the results of such tests to Strate Supervision. A Participant must ensure that the intervening period between two disaster recovery tests is no less than 3 (three) months and no greater than 9 (nine) months.

Directive SA.10 - Risk Management, further requires the results of DR testing to be submitted within 30 days from the date of the test.

The minimum information to be provided is also clearly laid out in Annexure A of the Directive. The following are some of the aspects that need to be reported on:

- Date of the test;
- The physical address of the site where BCP testing was conducted;
- The (critical) systems that were tested;



- The time taken to recover each of the systems listed;
- The recovery methodology used and details of what the test covered (and excluded);
- The parties who participated in the test;
- Any issues identified during testing and any recommendations made after the testing.
- How was the assurance provided for the test conducted?
- Confirmation of the retention period for backup records and/or key data of the systems.

Strate Supervision maintains a detailed database of the responses received from Participants to monitor their compliance with the applicable CSD Rule and Directive requirements.

### 6.1.7 Weekly and ad hoc BOR reports

Weekly and ad hoc exception reports are received from Strate Registry Services and reviewed for BOR validation and reconciliation errors made by Strate-recognised nominees and Participants. The exception report details errors in the actual context of the data submitted in the BOR file. The responsible nominee or Participant is advised of the exception and all errors are followed up until final resolution. The FSCA is notified of all material issues in respect of nominees. A database of all BOR issues is maintained.

BOR files are not applicable in the money market environment as central securities accounts at beneficial ownership level are maintained within the records of Strate.

### 6.1.8 Financial soundness requirements - review of annual financial statements/monthly management accounts

Reliance is placed on the SARB MOU for prudential regulation of bank Participants.

Non-bank Participants provide financial soundness reporting in terms of Strate Directive SA.2 directly to Strate Supervision. This is to ensure that such entities, which do not fall under the prudential regulation of the SARB, remain financially sound.

### 6.1.9 Compliance officer reporting

In terms of CSD Rule 8.3.2.5, a Participant's Strate Compliance Officer (SCO) must:

*"...submit a bi-annual report signed by the chief executive officer or designated officer of the Participant and the compliance officer, relating to the Business of the Participant which indicates any material problems that the directors or compliance officer have experienced during the preceding 6 (six) months and how these have been or are to be addressed. The report must include a disclosure and analysis of the impact on the solvency of the company of any material problems or losses experienced, risk management, internal controls and procedures implemented to mitigate the risks introduced, as well as any material claims of which the directors or compliance officer are aware."*

Adherence to Directive SA.3, SA.4, Rule 5.9.1 and 8.4.1 must also be confirmed on a bi-annual basis.

Reports for the period 1 January to 30 June are due by 31 July of each year, and the reports for the period 1 July to 31 December must be submitted by 31 January of the following year. Any issues disclosed or reported in the reports would in most instances already have been brought to the attention of Strate Supervision during the preceding six months.

SCOs have a daily oversight and reporting responsibility (of material issues identified). The nature and quality of all SCO reporting to, and correspondence with, Strate Supervision, and timely responses to queries, is also monitored.

A Participant must, in its biannual compliance officer's report submitted to Strate Supervision, attest that any SCO or alternate SCO (ASCO) appointed by the Participant has, in its opinion, the necessary knowledge, skill and competencies to perform the role.

#### 6.1.10 Compliance Officers Forum

Ad hoc meetings are held with SCOs to discuss *inter alia* market issues and trends, new regulatory or compliance developments as well as changes in legislation.

The SCO and/or ASCO appointed by the Participant should attend all meetings of the Compliance Officers Forum to ensure that they remain abreast of market developments.

#### 6.1.11 Strate Supervision attends meetings and forums

When Strate Supervision attends various market committee and forum meetings, it may highlight areas of regulatory and supervisory concern or focus.

#### 6.1.12 Ad hoc meetings with management

Ad hoc meetings may be held to discuss matters of concern regarding the performance or conduct of a Participant. Quarterly meetings are also held (where required) to discuss the Participant Monitoring Model (PMM) scores with Participants.

#### 6.1.13 Moral suasion (one-on-one discussions)

Discussions with the Strate Compliance Officer, head of Business Unit, management, directors, auditors, the Committee or ultimately Board of Directors may be held if deemed necessary.

#### 6.1.14 Strate Circular (external audit guidelines) and tri-partite audit meetings (pre and post)

The Strate Circular sets out the agreed upon procedures and controls to be performed and reviewed by registered auditors reporting on factual findings in respect of compliance by Participants with the Strate Rules, in respect of their implementation of internal controls to meet specified objectives for the settlement, custody and administration of Strate eligible securities.

The Strate Rules relating to the reporting responsibilities of registered auditors require that:

- 8.1.4 *The Registered Auditor responsible for the audit of the Participant must submit a s report annually to the Strate Board of Directors, within 90 (ninety) days after the financial year-end of the Participant which complies with the Strate Circular, the Act and Strate Rules. The Registered Auditor responsible for the audit of the SARB or a Participant which is also a bank, must submit the factual findings report within 6 (six) months after the financial year-end of such bank Participant or the SARB.*
- 8.1.5 *The Registered Auditor responsible for the audit of the Participant must annually report to the Strate Board of Directors whether :*
  - 8.1.51 *The Participant complies with the requirements of the Act and the Strate Rules regarding the maintenance of Securities Accounts;*
  - 8.1.5.2 *The Participant complies with the Strate Rules relating to the reconciliation of Securities Accounts to the Central Securities Accounts kept by Strate; and*
  - 8.1.53 *The Participant complies with Rule 5.1.1, and on the adequacy of the arrangements made and measures taken by such Participant on holding of sufficient Securities in terms of Rule 5.1. and*

*8.1.5.4 the Participant complies with the requirements of the Strate Rules and Strate Directives relating to settlement, and the processing of corporate actions entitlements that impact the balance of Securities in a Securities Account or a Central Securities Account.*

On an annual basis, Strate Supervision receives and reviews the requisite reports from Participant registered auditors. Any negative findings or discrepancies disclosed are carefully investigated to fully understand the reasons for any failure in controls and what steps have been taken by the respective Participant to mitigate against and prevent re-occurrences. Andrew to advise on email.

Tri-partite discussions are held prior to the audit to agree on sample sizes in respect of the audit to be conducted, as well as to ensure that registered auditors focus on certain areas of concern identified by Strate Supervision in the preceding year.

#### 6.1.15 Internal audit reports

Reliance can be placed on Rule 8.1.4 or the submission of audit reports in need.

#### 6.1.16 External IT audit reports

Reliance can be placed on Rule 8.1.4 for the submission of audit reports in need.

#### 6.1.17 On-site inspections

In sourcing information relating to the activities of a Participant, reliance is often placed on third parties, such as SCOs, co-regulators, the Participant itself, internal Strate divisions and registered auditors.

Such practices may lead to over-reliance on third party assurances and minimal direct, proactive supervision by Strate Supervision itself. As such, on-site inspections have become (and are regarded as) an important proactive supervisory tool, enabling Strate Supervision to obtain direct confirmation that regulated entities are complying with the FMA, Strate Rules and Strate Directives. On-site inspections further allow the division to obtain a level of understanding with regards to a Participant's systems of internal control, risk management processes and procedures.

On an annual basis, the approach to the on-site inspection programme and its scope will be determined with guidance from the Regulatory and Supervisory Committee.

The on-site inspection approach adopted by Strate Supervision aims to promote several outcomes and benefits, including, *inter alia*:

- Educating Participants about legislative requirements;
- Assisting Participants in identifying undesirable conduct and behaviour;
- Together with the Participant, identify ways to improve processes for the benefit of the Participants, Strate as regulator and market stakeholders; and
- Establishing processes to assist in resolving transgressions and discrepancies in order to reduce the exposure to risks.

Strate Rule 11.2.1 allows the Strate Board of Directors to investigate any Strate-related activities of a Participant or past Participant and requires Participants to furnish information on the subject of any investigation and to deliver any book, document, tape, record or other object, which has a bearing on the subject of the investigation.

Strate Supervision has developed a comprehensive on-site inspection manual which *inter alia* details:

- The criteria used by Strate Supervision to determine whether to conduct on-site inspections at Participants and review their custody and settlement related activities; and
- How the scope of an on-site inspection is determined.

### 6.1.18 Investor complaints handling procedure and database

Complaints against Participants (of any nature) are fed through to Strate Supervision for investigation. A database containing details of any complaints raised against Participants is maintained by Strate Supervision. A formal complaint handling procedure has been adopted to ensure the efficient and timeous handling of complaints brought to the attention of Strate Supervision. Strate Supervision will work with the Participant concerned and agree on any corrective action to be taken.

In terms of Strate Rule 15.3, *on an annual basis, the Regulatory and Supervisory Committee must submit a report to the Authority specifying the number and nature of all complaints received, the results of the investigations, and the actions taken to rectify them, if any.*

### 6.1.19 Strate training and Strate compliance examinations

Strate's learning material and workshops are administered by the Strate Academy. The Strate examination modules and learning material forms the basis or content of the prescribed compliance examinations as specified in the Strate Rules.

Strate conducts a series of one-day seminars, the purpose of which is to provide up-to-date, regular training on Strate-specific functionality, procedures and legislation. This provides a level of assurance that staff of Participants are being kept abreast of developments in the Strate environment and South African financial markets.

Registration for this examination is not limited to members appointed as Strate Compliance Officers, but is open to all candidates interested in obtaining Strate accreditation.

Strate Supervision also maintains a Compliance Officer Register for Participants.

Other Strate examinations are managed by the South African Institute for Financial Markets (SAIFM), with the exception of the examination for other exchanges: EESE and Cape Town Exchange. Examinations are conducted on any business day.

### 6.1.20 Information in the public domain

This involves identifying matters of concern in the news media or other publications. Information obtained through word-of-mouth, rumours or complaints by market stakeholders against Participants is also carefully considered and investigated where required.

### 6.1.21 Participant Monitoring Models (PMM)

Information obtained from the above listed sources is maintained and collated on various databases.

The PMM is a supervisory tool designed for Strate Supervision to have a collective view for each Participant performance. The results generated from the tool triggers the appropriate supervisory response.

Information from the various supervisory tools utilised by Strate Supervision is collated on a monthly basis into the PMM to create a supervisory tool capable of monitoring the operational performance of and highlighting the potential weaknesses within a Participant. It also provides valuable information on trends in respect of Participant activities.

The objectives and principles defined in the development of the PMM included:

- Easy to use - A model created in an Excel format which requires minimal effort and cost to run and maintain.
- Keep it simple – Avoid complicated solutions else implementation of the model would fail.
- Early warning tool - The model must be able to recognise potential weaknesses within a CSD Participant which would trigger an appropriate supervisory response.

- Red flags - The model must identify core criteria that are required to be met and any deviation would trigger immediate investigation.
- Multi-instrument - The model must be able to measure performance across securities.
- Black and white - The model must mitigate against personal judgement and be based on qualitative evaluation.
- Consistent - The model must be stable so as to ensure consistent month by month application across all CSD Participants.

On a quarterly basis, Strate Supervision provides the Committee and FSCA, as well as each respective Participant, with the results of the preceding quarter's monthly performance results. Any significant or continued deterioration in the overall performance scores of a Participant will result in Strate Supervision meeting with the affected parties to understand the reason/s for poor performance scores and the steps management are taking to improve areas of concern.

The following specific key operational areas are measured and scored in the models:

- Monetary fines or transgressions;
- Market volumes (including settlement volumes and assets under custody);
- Liaison with third parties (includes the number and severity of concerns raised by external stakeholders);
- Technical difficulties experienced (includes *inter alia* the number and severity of difficulties reported);
- Uncertificated Securities Accounts (includes issues such as BOR files related issues and account maintenance issues); and,
- Red flags (including *inter alia* debit balances of securities).

## 7. Management of conflicts of interest

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### 7.1 The Committee

As stated in clause 2 above, the Committee has been created by the Strate Board of Directors to oversee the regulatory, supervisory and enforcement functions of Strate in terms of the FMA and the Strate Rules. This is in accordance with the authority delegated to the Committee through a formal Terms of Reference that is reviewed and approved by the Strate Board of Directors on an annual basis.

In performing these functions, the Committee serves as an independent check on the appropriateness of Strate's regulatory activities. It establishes a regular reporting line between Strate the Supervision Division and the Strate Board of Directors.

The Committee has been tasked with overseeing the establishment of appropriate and effective internal governance processes to identify and manage potential, perceived or actual conflicts of interest between the regulatory functions and commercial services of Strate. The Regulatory and Commercial Conflicts of Interest Management Policy documented by Strate sets out the framework and key principles associated with ensuring that Strate's regulatory mandate is enabled, fairness and transparency are promoted and any actual, potential, or perceived conflicts of interests between Strate's regulatory functions and its commercial activities are avoided or appropriately managed.

### 7.2 Strate Supervision

In terms of the FMA, the CSD must ensure it has set up and maintains systems for monitoring compliance by participants with the FMA, Strate Rules and Strate Directives.

Strate Supervision maintains systems for monitoring compliance by Participants, officers, employees, and agents of the Participant with the provisions of the Strate Rules and Strate Directives as well as the surveillance and enforcement of any matter relevant for the purposes of the Strate Rules and Strate Directives.

Strate Supervision operates with the highest levels of confidentiality as it is privy to detailed knowledge and insight into Participants' operations. Supervision staff are bound by stringent confidentiality and code of conduct clauses and sign an annual declaration as confirmation of their understanding and adherence to these codes of conduct.

This division is accountable to the Committee for the supervisory, investigative and enforcement functions and reporting to the Committee and the FSCA on each Participant's compliance with the FMA, Strate Rules and Strate Directives. Appropriate measures to manage conflicts of interest between Strate's commercial CSD functions and its SRO functions have been established.

To this end, Strate Supervision employees are also constantly reminded of their duty to observe the highest professional standards and are given clear guidance on the avoidance of conflicts of interest, the possible abuses of confidential information, the observance of confidentiality and secrecy and the observance of procedural fairness.

### 7.3 Confidential information

Confidential information means all information of any nature whatsoever that Strate Supervision may obtain from another party (disclosing party) while performing the SRO function, or which:

- Is marked "confidential" (or has a similar legend)
- May be password protected.
- The disclosing party identifies as confidential.
- By its nature is confidential, such as reports, records, databases, and statistics pertaining to the performance, operations and structures of a Participant.

Confidential information includes information received orally, visually or by reason of inspection of documentation, electronic data or other material.

If Strate Supervision becomes aware of an operational problem experienced by a Participant that could impact or introduce systemic risk to the CSD functions of Strate, it may pass on this information to the relevant operational division within Strate.

If Strate Supervision obtains information on a Participant's proprietary practices, the information will be kept confidential from other market players, unless the Participant has given written permission for it to be shared for the benefit of the financial markets.

### 7.4 Special Purpose Reserve Fund - Fines

As discussed in clause 2.4 above, the FMA allows the CSD to impose penalties on its Participants for contraventions of the FMA, Strate Rules or Strate Directives. Funds collected through the imposition of monetary fines are allocated to a Special Purpose Reserve Fund (SPRF) and are not used to subsidise the costs or operational functions of Strate or Strate Supervision.

All the funds generated from fines imposed on Participants and business partners are accounted for separately in Strate's financial records. The SPRF is used to fund or subsidise special projects or market training initiatives and requires the prior approval of the Strate Audit and Risk Committee (ARC). Income or funds collected through fines are not classified as a standard revenue item and are not budgeted for.

## 8. External oversight

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Strate Supervision must ensure that the supervision and enforcement of the Strate Rules and Strate Directives is conducted and carried out in a transparent, equitable and consistent manner, and is subjected to regular independent audit reviews in this regard. As such, activities of the division are subject to review by the FSCA and Strate's Internal and external auditors.

Reviews that have been conducted to date have included:

- Verifying that Strate Supervision imposes monetary fines fairly and consistently across all Participants and in instances where fines were waived, that this was done in terms of agreed parameters and circumstances;
- Verifying the existence and effectiveness of confidentiality firewalls between the CSD and supervisory functions of Strate (before these were removed); and
- Verifying whether Strate Supervision has robust processes and controls in place to mitigate the associated risks applicable to the division. Compliance to the principles in the annual FSCA self-assessment return, applicable to Strate Supervision, was also tested.
- Assessing Strate's compliance with the duties imposed on it and its Participants under the FMA.

## 9. Conclusion

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As the primary overseer and regulator of Participants in the South African securities markets, the division will continue to work closely with the regulators and other self-regulatory organisations to ensure and promote the stability and development of the South African financial services industry. By doing so, the division aims to effect proper administration and enforcement of laws, regulations and rules governing the financial markets.