In pursuit of efficient financial markets for the SADC region

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The Centre of Excellence in Financial Services is a non-profit organization focusing on collaborative research, bringing together local and international thought leaders, industry experts and academics to interrogate the role financial services can play in achieving national and international objectives. This working paper is available in electronic format on www.Coefs.org.za.

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Preface

The title "In pursuit of efficient financial markets for the SADC region" is based on a series of conversations held with practitioners from South African banks. As their footprint onto the African continent grows, so they encounter a number of challenges that frustrate the development of vibrant financial markets in each country in the SADC region and thereby frustrating a vibrant financial market across the region.

One of the key challenges, is the lack of common legal documentation to underpin standard economic transactions. Here, international best practice provides a measure of comfort to policy makers and regulators, however inconsistent implementation and conflicting interpretations, reduces the safety net provided for both parties. We identified International Swaps and Derivatives Association and the International Capital Markets Association as two leading global trade organisations that have provided important documentation used in swaps and derivative transactions and bond repurchase transactions respectively, in many of the world's leading financial jurisdictions.

The benefits of adhering to these international standards are patent. These include a reduction in the risk of pools of inefficiency in the local interbank markets which can threaten the solvency of local banks, the efficient exchange of risks between market participants through the use of derivatives and repo's and the creation of deep, liquid, efficiently priced financial markets. More than 67 countries have reformed their local markets and local legislation to adhere to these standards including countries as widespread as Brazil, United States of America, Canada, England, France, Germany, Italy, Russia, India, Hong Kong, Japan and Australia.

The African continent is often challenged with financial markets that do not reach their full potential. In some instances, liquidity is trapped and unavailable, or risk builds up with no mechanism to transfer and manage proactively the risk appetite of the bank or company. While the documents prescribed by the International Swaps and Derivatives Association and the International Capital Markets Association are utilized by many multinational banks and corporations within SADC, 13 of the 15 countries within SADC do not have local laws and regulations which support and provide legal certainty in respect of the enforceability of key provisions in those documents. The consequence is that these documents are materially undermined, efficient markets are not possible and where market counterparties try to execute transactions notwithstanding these challenges, there is an additional transaction cost incurred, as the legal framework for company law and insolvency law does not recognize the concepts promoted in these documents.

Our focus is on SADC, where a framework for regional co-operation is actively promoted. Although this challenge applies to many other African countries as well, the Regional Indicative Strategic Development Plan provides an opportunity to begin framing a discussion around what may be required to promote a more efficient financial market for the region.

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Abbreviations

DRC	Democratic Republic of the Congo
G-20	Group of twenty
GMRA	Global Master Repurchase Agreement
IDA	International Development Association
ISDA	International Swaps and Derivatives Association
ICMA	International Capital Markets Association
NBFI	Non-Banking Financial Institution
SADC	South African Development Community

Executive Summary

The desirability of an efficient financial market within national borders is well documented. Cross-border financial integration as a regional goal, should recognise the need for national objectives to be co-ordinated under an appropriate regional organisation, facilitating change to national domestic legislation where appropriate. A process of subscription to international best practices will over time, provide the necessary benchmark from which each territory could be assessed for their compliance with this objective.

A critical path towards achieving these scholarly benefits would be to embrace regional harmonisation by introducing international standards for documentation that underpins cross border financial transactions. By adopting these international standards and addressing key legal impediments which currently exist within domestic legal frameworks, the recognition of international contractual arrangements would make provision for transactions with any jurisdiction and provide comfort to international investors, pan-African banks and firms with regional and international reach.

International organisations such as the International Swaps and Derivatives Association (**ISDA**[1]) and the International Capital Markets Association (**ICMA**[2]) provide globally agreed contracts, understood by industry participants including regulators and policymakers in both the derivatives and bond repurchase market. Embedding these contracts into the financial system will however require a review of each jurisdiction's approach to bankruptcy legislation. As an economic block, SADC is

[1] The ISDA Master Agreement provides a globally accepted standard for enforceability of netting and collateral for over-the-counter derivatives transactions by policymakers, regulators and supervisors, and financial institution around the world. For further information see www.isda.org

[2] ICMA publishes the Global Master Repurchase Agreement **(GMRA)** providing a legal agreement for repurchase transactions. For further information see www.icmagroup.org

encouraged to begin implementing a project to review insolvency legislation to meet a common objective for all its members.

A commitment to ensuring that each domestic legal framework recognises and upholds the legal enforceability of these international standard legal contracts would reduce the risk premium attached to transacting, and enable risk sharing through the transfer of risk to those parties willing and able to do so. For the systemic risk supervisor, understanding the impact of these contracts on a recovery or resolution workout is key to making informed decisions. Furthermore, domestic recognition could unlock risk sharing in country where counterparties that have a natural fit can trade domestically whilst allowing multinational banks and corporate entities to provide liquidity to those markets. There are many benefits which the SADC region could unlock through this process including the reduction of costs on legal and audit fees, the improvement of investor confidence and country risk premium, and the provision of tools to risk managers that can improve risk mitigation.

The learnings from the global financial crisis

The Bankruptcy of Lehman Brothers on the 14th of September 2008, the most widely publicised failure during what was to become known as the global financial crisis, demonstrated that financial markets do matter.

Although this paper will not explore the global financial crisis per se, it is worth mentioning the staggering impact that this failure had on global economies. The International Monetary Fund in 2009, estimated the global financial crisis had cost USD 12 trillion, and five years later, unemployment had grown by 30 million[3] globally. At the time, many commentators' made comparisons to the Great Depression of 1930, where banks began to fail almost a year after the Wall Street stock market crash in October 1929, as the only event to match in both scale and impact in recorded history.

The Bretton Woods Summit in 1944, demonstrated that even during the Second World War, financial markets were considered key to rebuilding the post war international economic system. The International Bank for Reconstruction and Development, recognised as the original World Bank together with the International Monetary Fund, were borne out of this event.

Similarly, the social cost of the 2008 global financial crisis together with the fracturing of trust between voters and their government and customers and their banks, forced politicians to act, and the Group of Twenty **(G-20)** was formed, with the first summit in Washington DC in November 2008.

Both the Bretton Woods summit and the establishment of the G-20 demonstrate that there is a compelling argument for financial markets to be used as a catalyst for economic change. In both instances, these interventions, led by politicians, were during periods of extreme hardship. The lessons learned from these events have redesigned global financial markets and increasingly over the last decade, these

[3] Financial Crises Causes, Consequences, and Policy Responses

markets are being used to shape desirable economic activity, from targeted interventions on specific activities such as securitisation and over-the-counter derivative trading, to addressing "too big to fail" concerns, by identifying globally and domestically significant financial institutions and imposing substantial requirements for the recovery and resolution of these entities, whilst making the broader financial sector more resilient to external shocks.

The Financial Action Task Force recommendations to combat money laundering and terrorist financing as well as the financing of weapons of mass destruction depends on the financial sector to identify and take action against abusers of the financial system.

Financial markets are therefore increasing in their importance to national policy makers, and where these markets are effective, they could become a catalyst to accelerated economic development.

South African Development Community

Within the 15-member states constituting SADC there are differences in both the maturity of financial markets and the source of economic activity, particularly those with natural resources such as the oil producing countries of Angola and the Democratic Republic of Congo (**DRC**), and the mineral rich countries of Botswana, Namibia, South Africa, Tanzania and Zambia.

Much has been written both theoretically and empirically about countries with either developing or emerging market status. The International Monetary Fund[4] has noted that the broader sub-Saharan region's level of financial development is below the international financial development benchmark, and raising the region to this benchmark would increase economic growth by 1.5 percentage points.

Further emphasis is placed on, amongst others, improving corporate governance and financial disclosure by "…aligning standards in accounting, auditing, and financial

[4] Financial Development in Sub-Saharan Africa: Promoting Inclusive and Sustainable Growth, September 2016

reporting with international best practices…" and when combined with active harmonisation of regulations and supervisory practices, this could positively impact on the closure of this gap.

The rise of the pan-African bank

The withdrawal of many internationally headquartered banks from the African continent, post the global financial crisis, has provided an opportunity for the creation of pan-African banks. Formerly large domestic African banks, they have expanded across the African continent providing much needed banking services. These banks operate across national borders and in most instances have a global footprint with operations in global financial centres such as London and New York.

Pan-African banks play an increasingly important role across the continent. In addition to the provision of attractive retail banking products to citizens of the various countries, the banks are able to provide liquidity and investment opportunities to key role players including Non-Banking Financial Institutions (**NBFI**'s) such as asset managers, pension fund managers and lifeco's as these participants seek to term match their income and policy obligations. The banks play in important role in supporting and providing financial products to key industries including mining, minerals and manufacturing. The banks also provide strategic funding and risk management solutions to central and state banks as they seek to roll out their infrastructure policies and strategies.

The experiences of these pan-African banks, when providing services to customers in countries on the African continent, forms the basis of this paper. It is through this lens that we consider the proposals set out below in an effort to provide a meaningful contribution to achieving an efficient financial market across the SADC region.

The role of derivatives and bond repurchase transactions in SADC financial markets

Local banks (including central banks) who raise funding offshore as well as large African corporates need to hedge certain business risks including most commonly interest rate, exchange rate and commodity risks. The most efficient approach to managing these risks across the international finance market is through the use of derivatives. Corporates may, for example, need to hedge against the risk of fluctuations in foreign currency in respect of any foreign currency commitments to which they may be subject in future. Similarly, in circumstances where corporates borrow money, and are obliged to make repayment of interest at a floating interest rate, they may need to hedge against the risk of adverse movements in the floating interest rate. Corporates commonly enter into interest rate and foreign currency swaps in order to hedge this risk.

Derivatives are also used extensively in the commodities market so that producers and end-users of commodities, precious metals and other metals are able to enter into forward sale agreements and other types of derivatives, to hedge against the risk of adverse price movements in the price of the commodity.

Banks and financial institutions are the primary providers of over-the-counter derivatives to large corporates, however, there is a large inter-bank derivatives market as well.

These derivatives transactions are typically entered into under standard term agreements published by ISDA, known as master agreements (ie the ISDA Master Agreement). As noted elsewhere in this paper, the harmonization of the documentation of derivatives promotes efficiently priced financial products.

In contrast with derivatives, repurchase transactions (**repo's**) are primarily a financing tool in terms of which a bank or corporate that is holding an excess of corporate or government bonds at any time may exchange these for funding with a willing market counterparty who has a corresponding requirement for the corporate or government bonds in their day to day activities. Repo's are typically short dated transactions with a large percentage of the transactions outstanding on any given day across the financial markets being less than 3 business day transaction. Repo's provide the most efficient tool in the financial markets to smooth out pools of illiquidity and inefficiency that arise through day to day banking activities.

It is important to note that although the term "repo" is used in many financial markets, there are very few markets in Africa in which the local concept of "repo" is consistent with the repo's that are transacted in the international banking markets. The key differential is the ability to out-right transfer legal ownership to the buyer of the bonds. This ability is fundamental in the efficiency of the repo product in removing inefficiency in the markets.

Repo's are similar to derivatives in that repo's are typically entered into under standard term agreements published by ICMA, known as master agreements (ie the Global Master Repurchase Agreement or GMRA). As with derivatives the harmonization of the documentation of repo's promotes efficiently priced financial products.

Identifying projects to close the gap

A series of challenges face the SADC region, and in this section, we look at some of the more important ones. SADC is by no means alone, as many of these issues are replicated across the globe in emerging markets.

Increase liquidity

Across the region we see challenges arising from day-to-day banking activity resulting in large pools of liquidity trapped within a small group of banks and other financial institutions in a market. It is regularly the case within SADC that in individual markets the concentration of the top three banks in aggregate can exceed 70%[5] of the market, introducing a conservative bias to lending and trading financial instruments across SADC. Rather than fulfilling the traditional role of financial intermediation, oligopolistic behavior increases interest rate spreads, disincentivising savings and making loans to the private sector more expensive. Risk aversion changes bank behavior and disproportionately more lending to government is favoured whilst interbank trading is limited to a few banks.

In most developed economies the capital markets compliment the banking sector by introducing longer term investment opportunities. However, in almost all SADC countries both the bond market and equities market in Africa are illiquid, with inactive secondary markets inhibiting the use of these products in the creation of liquid and efficient markets. This can also be said of currency markets.

As an interim measure, regional integration is seen as an opportunity to increase the size of the domestic markets and leverage the pricing, liquidity and existing information systems in the SADC countries that do have active secondary markets.

[5] Making Finance Work for Africa

Secondary market activity can be improved by allowing greater participation by holders of instruments and parties who wish to purchase these instruments and who in both cases are currently prevented from entering the secondary market due to regulatory restrictions. NBFI's such as pension funds, asset managers as well as corporates who issue bonds benefit from an active secondary market in various ways. One benefit is the yield pick-up from being able to enter into securities lending and bond repurchase activities with local banks, improving overall profitability of the portfolio. Another advantage is that in releasing these instruments into the market, the secondary market provides liquid and tradable prices that enable portfolio managers to revalue their portfolios based on current market prices.

Transparent pricing can increase demand for tradable instruments improving liquidity. With a higher transaction turnover, investment in technology is therefore justified introducing second round effects of greater transparency which can lead to better portfolio allocations and less idle liquidity.

Governments can be placed under increasing pressure to transform economies due to the inefficient allocation of the financial system. Improving the efficiency of the financial markets by unlocking pools of liquidity can remove some of these pressures as the financial markets serve a greater proportion of the economy and government continues with strategic initiatives.

Accessing international capital flows

The International Monetary Fund[6] describes essential financial markets as a combination of capital markets, money markets, foreign exchange markets and derivative markets. In their research, which focuses on the availability of investment instruments, they further describe complete capital markets as having government securities markets for treasury bills and treasury bonds, and both a company bond market and equities market. In the SADC region there are six countries that qualify

[6] Sub-Saharan Africa's Integration in the Global Financial Markets

under this definition, Botswana, Namibia, South Africa, Swaziland, Tanzania and Zambia.

Domestic capital market development has been identified as a major determinant of international capital flows, whilst the quality of domestic financial institutions contributes significantly in attracting these capital flows, particularly the private capital inflows of foreign direct investment, foreign portfolio investment and private debt flows, comprising bank loans and bonds. Although the International Monetary Fund was unable to conclusively determine the impact of private capital flows on growth, without further research, the importance of international capital flows to finance current account deficits will continue.

The global financial crisis and the subsequent recession has not only reduced private capital flows globally, but also increased risk aversion. This will impact negatively on donor funding to low income countries such as the DRC, Lesotho, Madagascar, Malawi, Mozambique, Tanzania, Zambia and Zimbabwe, which receive International Development Association **(IDA)** donor funding, part of the World Bank. Countries in the SADC region will therefore need to attract private capital flows to finance current account deficits, with reduced levels of donor funding.

Developing well-functioning essential financial markets, that have depth and provide the comfort of international best practice, with not only skills transfer amongst market participants to facilitate a vibrant market, but also robust regulatory and supervisory frameworks, is essential to attracting scarce and risk averse private capital.

Create access for companies

Large African companies are becoming global franchises with operations in multiple jurisdictions. Not only are they offering their products across borders, they are also funding their operations in the international markets, introducing currency risk to the management of their business activities.

With the majority of SADC countries[7] following a floating exchange rate regime, policy makers therefore concentrate on managing the volatility of their currency, where possible. With lower volatility, long-term domestic company assets become more attractive to international investors.

The emergence of these new companies requires a comprehensive review of the ability of domestic companies to understand and manage the risks inherent in their business activity. This is best achieved by equipping domestic banks with suitable risk mitigation products, enabling them to assist domestic companies in the management of these new cross border and currency related risks.

For managers of currency risk, access to derivative markets is critical. The ability to use derivative products such as forward exchange contracts, options etc. allows for active currency management that improves the certainty required to manage the quantum of cash flow obligations and reducing fluctuations in projected income. These are standard products that are transacted internationally under the ISDA standard form market documentation.

The World Bank[8] has identified country risk as one of the competitive disadvantages faced by emerging-market companies. This country risk exacerbates the risks arising in jurisdictions whose laws, regulations and market practice is not supportive of the international standard documentation and market practice endorsed by organisations such as ISDA and ICMA. The consequence is that foreign investors typically seek larger risk premiums from emerging market companies that are not required from their competitors from developed countries.

Econometric analysis suggests that a ten percent reduction in a country's perceived economic risk will reduce company bond spreads by 52 basis points, with a ten percent decline in perceived financial risk reducing spreads by 63 basis points equivalent to a two notch credit rating upgrade.

[7] Madagascar, Malawi, Mauritius, Mozambique, Seychelles, South Africa, Tanzania and Zambia
[8] The Globalization of Corporate Finance in Developing Countries

Decrease transaction costs

Within the narrative of the pursuit of efficient financial markets, the size of the domestic financial sector does play a role, and what the World Bank[9] refer to as small financial systems, will most likely be limited with more expensive, poorer quality financial services than their larger counterparts.

Of the approximately 195 countries in the world, 60 countries have a financial system, measured in terms of M2, less than USD1 billion, the size of a small bank in an industrialized country. In the SADC region, nine[10] countries are included in this measure, and when increased to USD10 billion, this increases to 14 of the SADC countries with the only exception being South Africa.

Relative size can mean fewer domestic institutions, with reduced competition and efficiency and the World Bank, using bank interest rate spreads between lending and deposit rates as a proxy, confirms that in smaller financial systems the spreads are higher, concluding that financial size does matter. Their research goes further in estimating that the "doubling of financial size would lower bank interest spreads between 21 and 40 basis points".

Regional financial integration is proposed as an approach to achieving a holistic financial system of financial contracts, markets and intermediaries that contribute to reducing the costs associated with acquiring information that leads to a more efficient capital allocation, mobilizing and pooling savings and reducing transaction costs in the exchange of goods and services.

Three policy choices are proposed to overcome the problems associated with small financial systems, opening markets to international capital flows, encouraging the use of foreign financial intermediaries and full or partial integration of such financial system with those of other countries within the region.

[9] Policy for Small Financial Systems – Financial Sector Discussion Paper No. 6
[10] Angola, Democratic Republic Congo, Lesotho, Madagascar, Malawi, Mozambique, Seychelles, Swaziland and Zambia

The domestic reform agenda, in preparation for regional integration, will yield benefits in domestic regulation. Embracing regional integration should improve financial institutions, markets and infrastructure, driving down domestic spreads and fees, through lower financial transaction costs and cross-border payments by the introduction of increased domestic competition.

The domestic reform agenda is key to unlocking the benefits of regional integration. This reform agenda could be coordinated through the subscription to international best practices rather than coordinated through one of the many regional groups operating in Sub-Saharan Africa.

The European Market Infrastructure Regulation

The European Market Infrastructure Regulation (**EMIR**) - Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories introduces a requirement to exchange margins on non-centrally cleared OTC derivatives. In October 2016, the European Commission proposed technical standards which set out detailed rules on collateral that must be exchanged with respect to OTC derivatives not cleared by a central counterparty. The impact of the new margin requirements put in place may be reduced by certain exemptions and limitations provided under the margin rules. One of the exemptions that apply to the margin requirements is non-netting jurisdictions.

The detailed rules on collateral requirements make specific provision for derivatives with counterparties in third countries, where the legal enforceability of netting or collateral protection cannot be guaranteed or enforced with certainty at all times. It is important that counterparties critically assess the legal enforceability of their netting agreements. It is possible that due to the legal framework of a third country that the assessments may be negative, as with non-netting jurisdictions, thus the counterparties are required to rely on arrangements from a two-way exchange of margins.

With the aim of ensuring uniformity with international standards and to avoid circumstances in which it becomes impossible for Union counterparties to trade with counterparties in non-netting jurisdictions, a minimum threshold below which counterparties are not able to trade with non-netting jurisdictions without exchanging initial or variation margins becomes appropriate. Exposures from contracts with non-netting jurisdictions that are not protected by any exchange of margin, because of the legal impairments in non-netting jurisdictions, should be constrained by setting a limit.

The limit chosen should be set at a very low level to avoid the possibility of increased systemic risk and to avoid chances that the detailed treatment would create the possibility to circumvent the provisions of this Regulation. The treatments put in place may be considered prudent, because there are other risk mitigation techniques that may be adopted as an alternative to margins. For example, because the netting arrangements are not legally enforceable and cannot be recognised for regulatory purposes, credit institutions are more inclined to hold capital for cross-border OTC derivative contracts with counterparties in non-netting jurisdictions.

Addressing the challenges

Nobel Laureate Eugene Fama is accredited with describing an efficient financial market as "one in which prices always fully reflect available information". This may be true of exchange traded equity markets where asymmetric information is proactively addressed. However, for purposes of this paper, the price may inadvertently contain a premium that is better described as an inefficiency premium.

The bond repurchase or "repo" market plays a pivotal role in the modern financial ecosystem, reducing the inefficiency premium by linking a variety of financial market participants by providing a market for secured, short-term borrowing and lending. Repurchase transactions, underpinned by legally enforceable documentation, provides an essential funding mechanism for market makers of sovereign and company debt and thereby contribute significantly to secondary market liquidity in domestic and international debt markets. Capital market instruments used in repurchase transactions can aid price transparency and assist with portfolio valuations.

The repo markets provide a mechanism that connects derivatives to their underlying cash securities, in particular exchange-traded bond futures and options. Liquid and efficient derivatives markets are relied upon by both financial and corporate institutions to hedge and disseminate their interest rate exposures. Often overlooked, the repo market is also where collateral is priced, sourced, and mobilised, allowing a whole range of financial and corporate institutions to meet the margining requirements that increasingly underpin today's financial markets. The repo market can also be viewed as an important channel through which central banks' target bank reserves and transmit monetary policy.

A well-functioning repo market is a critical success factor for the overall health of the capital markets through which governments and companies can raise funding and investors and savers can earn returns and capital growth.

Uncertainty amongst financial market participants has led to further investigations into the legal frameworks of a number of SADC jurisdictions. Although this paper does not provide a legal opinion of each jurisdiction, the content has been informed by in country investigations which include legal opinions sought by various banks.

We have previously noted the important role played by organisations such as ISDA and ICMA in the development of emerging financial markets. Once a jurisdiction has reformed its local legislation, regulations (including in respect of the functioning of the local bond markets), these international organisations instruct a local law firm to provide an industry legal opinion on the extent to which local laws and regulations support the enforceability of the ISDA Master Agreement and the GMRA. Once clean netting opinions are obtained, these are published and made available to approximately to 1,000 international banks, governments and corporate entities that are members of these organisations. The clean legal opinion serves as a "green light" that the country in question is open for business in the international financial markets.

Our proposal is that each jurisdiction in SADC aim to achieve the legislative, regulatory and market reforms necessary in order to facilitate these clean industry legal opinions.

From a legal perspective, in our view each jurisdiction in SADC should assess their legal framework against four key areas, close-out netting and associated insolvency procedures, collateral, gambling and conflicts between laws.

Taking each of these in turn,

CLOSE-OUT NETTING:

This concept exists in both the ISDA and GMRA documentation and it provides for the netting of multiple individual transactions between the same counterparties such that a liquidator of one or other party is required to take account of the relationship between the parties in its entirety rather that "cherry picking" amongst the individual transactions. This is a very important consideration in for example the provision of exchange rate risk mitigation for an importer/exporter whose requirements may change week-to-week. A bank will be able to offer much cheaper financial products to the importer/exporter if it knows that contrary transactions will net against each other at all times. Similar principles apply in a repo transaction where parties require legal certainty that the financing and bond transfer legs will not be bifurcated.

COLLATERAL:

The ISDA documentation provide for the posting of collateral to alleviate the credit risks arising under derivative products and the parties executing these provisions require legal certainty on the enforceability of collateral against the underlying exposures.

GAMBLING:

In some jurisdictions the local legislation does not provide certainty regarding the commercial rationale for the mitigation of the risks discussed herein, leaving the risk that such transactions are considered to be gambling.

CONFLICT OF LAWS:

International market participants require certainty as to how other legal regimes are treated under local legislation, including considerations such as the application of foreign judgements, the application of international arbitration rules, whether the selection of a governing law other than the local law will be respected, etc.

We have set out below a high-level, preliminary summary of issues and challenges which we have identified in the local laws of each jurisdiction in SADC and which as currently drafted preclude adherence to the international best practices we have discussed herein and therefore the development of liquid, efficient, deep financial markets in each jurisdiction. The summaries provided below are not exhaustive.

These interpretations of the legislative frameworks in SADC countries serve as a starting point for a more robust evaluation, which could over time, provide the necessary legal certainty required to obtain a clean legal opinion. Enforceability of early termination and close-out netting in the event of insolvency of a counterparty is key to meeting the prudential requirements of banks under Basel III. The credit risk assessment translates directly into capital adequacy requirements and close-out netting can be recognised as a net amount for capital purposes, if the legal framework in the relevant jurisdiction can be satisfied by a clean legal opinion.

Angola

The legal framework considered in Angola included the Civil Code approved on November 25, 1966 (the Civil Code), the Civil Procedure Code approved on December 28, 1961 (the Civil Procedure Code), the Financial Institutions Law, approved by Law nr.13/05, dated 30 September 2005 (the Financial Institutions Law), and the Foreign Exchange Law approved by Law 5/97, dated 27 June 1997.

However, when considering insolvency, the legal framework differentiates between types of legal entity. The Financial Institutions Law would provide a legal framework for banks, with insurers and the stock exchange being regulated separately. Company entities are catered for under common law in the Civil Procedure Code. There are specific industries such as the oil and diamond industry that may have a dedicated regulatory framework.

In Angola, the Civil Code should recognize set-off and netting under the 2002 Master Agreement for both banks and the majority of companies, where both credits are fungible. Banks are supervised by the Angolan Central Bank, Banco Nacional de Angola, whose mandate extends to the recovery of, and the winding up of banks. Where the automatic early termination clause has been elected by the parties, any corrective action taken by the central bank would trigger the early termination clause immediately prior to the central bank action.

Where automatic early termination is not elected, we believe that the position of the Central Bank is stronger and corrective measures may extend to the suspension of obligations under ISDA.

For companies, the Civil Procedure Code requires that the set-off declaration must be served to the insolvent before bankruptcy is declared. The ISDA automatic early termination clause would meet this requirement as it was served at the time the ISDA Master Agreement was signed. Where the ISDA Master Agreement was signed within the year before the courts declared the company insolvent, the contract could be set aside as it can be deemed *mala fide*.

Where there is no automatic early termination, serving the declaration of set-off to the defaulting company after bankruptcy is declared, may result in the non-defaulting party being obligated to pay to the bankrupt estate and wait for a pro-rata claim, or any claim for damages arising from the default, as a creditor.

Botswana

A petition for the winding up of the company, filed by the Registrar of the High Court would be sufficient to trigger a freeze of the insolvent estate, suspending all obligations until the liquidator is appointed. The petition, hinges on the recognition of a group of creditors, the *concursus creditorium*, as having a valid claim against the bankrupt entity.

The Insolvency Act specifically positions the liquidator as equal to a secured creditor for purposes of an insolvency. The liquidator is prevented from cherry picking, and the ISDA master agreement would therefore be viewed as a single agreement. The liquidator may elect to terminate the contract without any performance obligations. Where the creditor accepts the termination of the contract, they may claim for damages or breach of contract. If the creditor does not accept the termination, the creditor must settle their obligations to the liquidator and claim.

The ISDA master agreement termination and bilateral close out netting should be enforceable as it does not contravene Botswana law or public policy and the right of termination would accrue prior to the group of creditors being established. A notice to terminate after the group of creditors has been established would more than likely fail.

In the absence of legal precedent, the automatic early termination agreement under the ISDA Master Agreement may be viewed by the courts as an attempt to limit the rights of the liquidator.

Malawi

ISDA and GMRA contracts benefit from the general principle of Malawian law upholding the freedom of contract although there is not much law, no court precedent and minimal academic analysis on contracts and transactions of this nature. Courts are likely to take account of court precedent from English courts.

Financial institutions are governed by the Financial Services Act. The Act permits the Registrar, where it believes the institution is acting in a financially unsound way, to instruct a financial institution how to act under an agreement it has executed, including prohibiting payments which are required under a contract where it believes such payment to be contrary to the interests of the institution. In the case of financial institutions that are placed under statutory management, the statutory manager is authorized to repudiate existing contracts where considered not in the interests of the clients of the financial institution.

More generally netting is not envisaged under the Insolvency Act however the mandatory set-off provisions under the Insolvency Act may achieve a similar economic result.

Mauritius

The legislation in Mauritius is supportive of derivative and repo contracts and the relevant legislation, including insolvency legislation, has been amended in order to uphold the provisions of the ISDA and GMRA agreement. Netting post the insolvency of a Mauritian party to an ISDA or GMRA agreement is protected.

Mozambique

The choice of legal jurisdiction, such as the election of English law under an ISDA contract, may not be upheld given that bankruptcy legislation for Mozambican registered companies, determines material contractual provisions such as termination and set-off under bankruptcy. It is unlikely that the two parties to the ISDA contract would be able to elect an unrelated jurisdiction unless a party could demonstrate a compelling connection to an element of the contract.

In our view, provisions contained in articles 1140 of the Civil Procedure Code allow for "measures to prevent bankruptcy" that introduces a form of receivership allowing for all claims against a bankrupt estate to be suspend, which should include the termination provisions of the ISDA Master Agreement. The election of an automatic early termination would therefore not be recognised.

Should bankruptcy be declared the provisions of article 1197 does not recognize automatic termination of contracts with enforceability at the election of the receiver. Therefore, the ISDA contract cannot dissolve the governing rules of the bankruptcy legislation and automatic termination of all transactions would not be enforced. However, if the receiver did decide to terminate under the ISDA Master Agreement it would apply to all transactions.

There are similar provisions under Banking Law where a bank is in financial difficulty, the Central Bank (Bank of Mozambique) can intervene by appointing a provisional administrator with powers to suspend all claims against the bank.

The Civil Code does not recognize the principle that the ISDA Master Agreement is a single agreement and that each confirmation forms part of such agreement. Therefore set-off would not be considered as netting of amounts under a single transaction, but rather under each transaction. The enforceability of the close-out netting provisions under the ISDA agreement have been upheld in Portuguese law requiring specific legislation providing an exception to basic legal principles. Therefore, with Portuguese law providing the foundation for Mozambican contractual law, a basic principle of equality amongst ordinary creditors in bankruptcy proceedings would override the close-out netting provisions that would favour certain creditors over others.

Termination prior to the deceleration of bankruptcy may allow for netting of termination values as it is specifically provided for under article 1220 of the Civil Procedure Code, however once a receiver is appointed all claims may be suspended. The Civil Procedure Code also provides for contractual set-off amounts that were not yet due and payable, 12-months prior to bankruptcy being declared as an act of bad faith.

A similar approach to termination would apply to banks where netting of termination values would be enforceable up and until the Central Bank appoints an administrator, where all claims can be suspended. Under article 12 of the Law on Liquidation of Credit Institutions and Finance Companies, netting of termination values must have been in place before the deceleration of bankruptcy and would be limited by the rules of sett-off.

Namibia

The insolvency of a party to a contract does not automatically terminate a contract under Namibian common law. The contract may be suspended, and the liquidator can elect whether or not to honour or terminate the contract.

The establishment of the *concursus creditorum* effectively freezes all actions against the insolvents estate in order not to prejudice the rights of other creditors. Therefore, early termination before the *concursus creditorum* becomes effective, the termination of all the contracts under insolvency would be enforceable.

Similarly, automatic early termination triggered by a specified default other than insolvency would be enforceable if the default did not give rise to the *concursus creditorum*.

Seychelles

The provisions of derivatives and repo contracts are generally enforceable in accordance with their terms during the course of the contract. The law of Seychelles is generally supportive of derivatives and repo products.

In certain circumstances however, the Insolvency Act 2013 will take precedence over the terms of ISDA, GMRA or other similar contracts that treat all transactions as a single agreement and that prescribe close-out netting. Although the economic outcome may be preserved, primarily through the application of the insolvency set-off mechanism prescribed in the Act, this will be achieved under the provisions of the Act and not in exact accordance with the terms of the derivatives or repo contracts.

Challenges may also arise when the English form of the Credit Support Annex is utilized by the parties. This form of Credit Support Annex prescribes an outright transfer of collateral which may be challenged where the collateral has a greater value than the close out amounts under the agreements and the transfer of collateral also risks recharacterisation as a security interest.

South Africa

Under South African law, post insolvency netting which occurs under standard ISDA Master Agreements are enforceable post insolvency by virtue of section 35B of the South African Insolvency Act, 1936 (Insolvency Act). Currently, the opinions issued by Cliffe Dekker Hofmeyr Inc. dated 20 December 2016 confirm the validity and enforceability (and applicable special considerations) of collateral arrangements under the ISDA Credit Support Documentation. In addition, a Webber Wentzel Bowens opinion further confirms the validity and enforceability of netting arrangements under the ISDA Master Agreements. Section 35B of the Insolvency Act provides that all unperformed obligations arising out of one or more master agreements between two parties (or the obligations arising out of an agreement in respect of which assets have been transferred as collateral security) will, upon the liquidation of the estate of the insolvent party:

terminate automatically on the date of liquidation

the values of the unperformed obligations will be calculated at market value as at the date of liquidation

the values calculated will be set-off or netted against one another, and

the net amount will be payable by one party to the other.

Section 35B of the Insolvency Act specifically defines a "master agreement" as an agreement in accordance with standard terms published by the International Swaps and Derivatives Association, the International Securities Lenders Association, the Bond Market Association or the International Securities Market Association, or any similar agreement, which provides that, upon the sequestration of one of the parties:

"*(a) all unperformed obligations of the parties in terms of the agreement -*

(aa) terminate or may be terminated; or

(bb) become or may become due immediately; and

(ii) the values of the unperformed obligations are determined or may be determined; and

(iii) the values are netted or may be netted, so that only a net amount (whether in the currency of the Republic or any other currency) is payable to or by a party, and which may further provide that the values of assets which have been transferred as collateral security for obligations under that agreement shall be included in the calculation of the net amount payable upon sequestration;"

This means that the liquidator of an insolvent South African party to a master agreement may not unwind a set-off or netting which occurs between two parties upon the insolvency of a South African counterparty. Thus, under South African law, counterparties may enter into netting agreements like the ISDA Master Agreement and rely on the netting benefits of the ISDA Agreement both pre- and post-insolvency.

Swaziland

Derivative and repo transactions are valid and enforceable in Swaziland. The choice of law of contracting parties is generally upheld with some exceptions in respect of Government entities.

Although the provisions of ISDA and GMRA agreements are enforceable during the term of a transaction, they remain subject to other legislation in insolvency. Under the provisions of the Insolvency Act 1955 a liquidator of a company has the power to set aside the netting provisions in an ISDA or GMRA. In contrast however, the terms of the Financial Institutions Act 2005 prevail over the Insolvency Act in respect of certain contracts entered into by registered financial institutions and there are scenarios in which the single agreement and netting provisions in an ISDA or GMRA would be upheld by a curator of a financial institution.

There are no restrictions in Swaziland law regarding the types of derivatives or products that may be referenced by derivatives.

Tanzania

The Bankruptcy Act specifically provides for netting, and therefore we believe that set-off and netting under ISDA would be upheld by the Tanzanian courts for companies. This should also apply to an early termination date after insolvency proceedings have commenced. The High Court has the power to void a contract that was either undervalue or introduced a preference, by a Tanzanian company to a third party, within two years of insolvency proceedings where undervalued, and within six months where preference was given.

A Tanzanian bank, that is either insolvent or bankrupt, is managed by the Tanzanian central bank (Bank of Tanzania). The Banking Act provides the central bank with powers to declare a moratorium on payments from the failed bank to creditors. The ISDA provisions of netting and set-off could be disregarded and the central bank can elect to repudiate any pre-existing contract. The central bank can also void the transfer of assets.

Automatic and early termination on an event of default would not be enforced where the counterparty is a bank, whilst a Tanzanian company, through the Companies Act, would recognize the ISDA default events.

Zambia

In our view, the Bankruptcy Act provides for netting and therefore set-off would be upheld. The ISDA master agreement provides for all transactions to be netted on the occurrence of default. As netting under the Bankruptcy Act is influenced by the intention of the contract, the master agreement will be upheld with any funds due after netting to the solvent party, being recognized as an unsecured debt.

The Electronic Communications and Transactions Act No 21 of 2009, recognizes that agreements concluded by electronic communication such as emails, are legally enforceable in the absence of a signature or acknowledgment of receipt. This will introduce an additional challenge where derivative contracts may become valid before the transaction has been through a governance process.

Zimbabwe

The transition from the official Zimbabwean dollar to a multi-currency system which includes among others the following currencies the United States dollar, South African rand, British pound and Botswana pula, as legal tender, has introduced a conflict with Zimbabwean exchange control regulations that have not been amended. Although it is common cause that both the Minister of Finance and Governor of the Reserve Bank have openly promoted the use of multi- currency accounts, making foreign payment is in fact restricted without prior approval of the Reserve Bank directly, or through its appointed authorised dealers.

The prohibition extends further than currency and includes all securities as long as there is an issue of cross border remittances of money involved. Prior approval of the Reserve Bank is required for any Zimbabwean to make a payment outside of Zimbabwe or transfer title to non-Zimbabwean residents or companies. This is done to manage the balance of payment for the country. Once approval has been granted, funds can be moved in country and utilized. At the time the person intends to disinvest from Zimbabwe, they have to notify the Reserve Bank through the authorised dealer that they are disinvesting.

In light of the above, the automatic early termination clause should be recognized, as neither insolvency law nor company law specifically address this matter, hence reference would have to be made to the common law. It is agreed that if parties agree to include a particular provision in their agreement, as long as it is not contrary to the laws of Zimbabwe, the court will uphold it. However, set-off would not be allowed once the process of winding up of the company has begun, because once the process has begun, it has the effect of freezing or stopping any legal action against the company (debtor). The creditors of the company would have to wait until a Liquidator has been appointed by the Master of the High Court. Once appointed, the Liquidator has the freedom to manage the process to the best of their abilities as long as it is in light with the requirement of the Companies Act. Of paramount importance is that, they should ensure that the best interest of creditor is served during this process, which means that no special treatment may be afforded to a group or a specific creditor at the expense of the rest of the group.

In managing this process, the liquidator will also look at some of the following issues:

The residual funds available

The number of creditors and amounts outstanding for each creditor

The status for each creditor i.e whether they are secured or not secured.

Secured creditors are preferred at the time of distribution of the company assets at the end of the winding up process.

There are provisions in the Insolvency Act that allow the liquidator, with the approval of the Master of the High Court, to reverse the debt due to the bankrupt company, prior to the sequestration or at a time when they are insolvent (impeachable transactions). This may introduce a challenge for derivative contracts.

Conclusion

An important contribution to unlocking the SADC regions financial integration is the harmonization of transaction documentation across the region.

Accessing international capital markets and transacting with off-shore entities requires a commitment to standardised documentation. International organisations such as the International Swaps and Derivatives Association and the International Capital Markets Association provide standardised documentation, understood by industry participants including regulators and policymakers in both the derivatives and repurchase market.

A commitment to ensuring the domestic legal framework recognises such legal contracts would reduce the risk premium attached to transacting, and enable risk sharing through the transfer of risk to those parties willing and able to do so.

Parties to a contract can elect a jurisdiction in which to have their dispute resolved. For the systemic risk supervisor, understanding the impact of these contracts on a recovery or resolution workout is key to making informed decisions.

Furthermore, domestic recognition could unlock risk sharing in country where counterparties that have a natural fit can trade domestically whilst allowing speculators to provide liquidity to those markets.

There are many initiatives emanating from the Basel Committee on Banking Supervision and the International Organization of Securities Commissions to standardise global financial activities.

The SADC region could reduce costs on legal and audit fees, improve investor confidence and country risk premium, and offer tools to risk managers that can improve risk mitigation.

Following on the success of the SADC Integrated Regional Electronic Settlement System, a harmonisation project must be driven by the regulatory community across SADC for it to be successful.

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