TITLE PAGE

The Conflict for STRATE in being both Regulator and Service Provider

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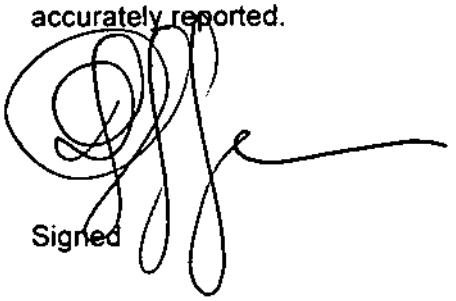
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I certify that, except as noted above, the report is my own work and all references used are accurately reported.



Signed

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Chapter 1: Orientation

1.1 Introduction

Is it healthy as well as free and fair for a regulator in the financial services environment, to become a service provider as well in the same industry to where he subsequently act as one of the regulators?

This whole question, as well as the debate surrounding it all started with the purposed acquisition of Ultra Registrars by Share Transfers Totally Electronic (STRATE), during the month of June 2005.

Ultra Registrars (Pty) Limited, is a company that provides registrar services to companies listed on the Johannesburg Security Exchange of South Africa (JSE). In other words, Ultra Registrars act as transfer secretaries for those listed companies, by providing them with all their shareholder information and oversees their dividend payments to name a few.

STRATE Limited, on the other hand is a company controlled by the JSE with a shareholding of 41%, followed by the four major banks in South Africa, being ABSA Limited (12.7%), First Rand Bank Limited (12.7%), Nedbank Limited (16.6%) and Standard Bank Limited with 16.8%. Citibank is the other shareholder, but with a smallholding of only 0.1%. STRATE was mainly formed by way of reducing risk and to improve the efficiency in the South African equities market, while simultaneously introduce international settlement standards. Equity certificates will be a thing of the past when a paperless Central Securities Depository (CSD) is established and transfer of ownership is affected by electronic book entry. The electronic settlement system is vital to bring South Africa in line with international practice and to enhance the security and efficiency of settlement in the South African market. (Field, 2001).

The old system operated by the way of stockbrokers who acted on behalf of the buying and selling parties. Custodian banks that hold the physical share certificates in their vaults are then instructed by the selling stockbroker, on behalf of his client, to remove the share certificates in respect of the sale from the fault and hand them over, in addition to a signed transfer deed, to the stockbroker acting on behalf of the buying party. This transaction can only be effected if the stockbroker acting on behalf of the buying party hands over a cheque for the purchase price at the same time. The custodian bank of the selling party then banks the cheque into the selling clients bank account, whilst the custodian of the buying party will ' on deliver' the certificate and

the signed transfer deed to the Company Registrar in order to register the name of the new owner of the shares into the company's records. If this process occurs without a problem the whole transaction may be completed in two weeks. If there are delays on any side the process may take months. The risk that one leg of this extended transaction fails is quite real and therefore a risk of non-receipt ownership by the purchaser or non-receipt of cash by the seller is not impossible.

There is therefore a danger that the share certificate is a forgery, and this will only be discovered at the Company Registrar, once the cheque has been paid; or the share certificate may be handed over in return for the cheque, which is then dishonoured be the paying bank. Either the share certificate or the cheque can be lost or stolen in transit between the parties involved and when these transactions amounts millions of Rands the international investing companies become very nervous. Therefore the need for an electronic CSD has become imperative to reduce these risks in the settlement system, streamline the process and reduce the time frame from weeks to minutes. Furthermore, share certificates circulating in the market place, by the means of physical delivery, carry with them the risk of fraudulent action, loss and theft whilst requiring the maintenance of cumbersome administrative processes. The overall costs within such an environment tend to be higher than with an electronic settlements system. The need to establish a CSD for equities in South Africa will therefore have the benefits of a reduction in administrative costs and improvement in efficiency.

In a resent case study done on Centralised Securities Depositories by Field (2001), he mentioned that the Bank of International Settlements (BIS) defines a CSD as a facility for holding securities, which enables securities transactions to be processed by book entry. Physical securities may be immobilised by the depository or securities may be dematerialised (i.e. so that they exist only as electronic records.)
The main feature of the depository system is the procedure applying to the transfer of deposited securities. It is executed on the basis of accurate orders given by the depositor to the clearing corporation whereby purported transfer are debited and credited to the relevant accounts. The number of accounts and sub-accounts shall be consistent with the numbers of deposits and principals as well as the class and type of deposited securities. Depositors give the CSD instructions to transfer, pledge or

withdraw securities. It should be noted that this system facilitates the transfer or pledge of securities with no need for them to be physically delivered or registered in the issuers' records, since transactions are shown by means of bookkeeping entries in the CSD's records. "The CSD is held liable for the loss or elimination of the stock certificates under the custody system, even in the case of unforeseen events, i.e. an act of God", (Field, 2001: 41).

South Africa was among the last of the world's top 15 bourses to enter the electronic settlement arena. The 1st phase of STRATE was implemented at the end of September 1999. Between then and January 2002, every listed equity on the JSE Securities Exchange South Africa (JSE) migrated to STRATE and the ambitious "best of breed" objective was met in the process (STRATE, 2004: no page).

Harmony Gold acted as the pilot company and was successfully transferred to the electronic settlement environment in 1999. This smooth transition prompted the migration of further counters to STRATE ahead of official implementation in 2001. All JSE listed securities do all their settlements via the STRATE system. In addition, the JSE guarantees all main board transactions and as a result there has not been a single failed settlement for main board trades on the JSE since the introduction of STRATE.

STRATE as the Central Securities Depository is subject to the supervisory functions of the Financial Services Board (FSB), as well as the Registrar of Securities Services. Further within the securities services environment, the following markets can be identified:

- The market for the holding of a centralised securities depository, whereas STRATE has the monopoly as a result of the Securities Services Act No. 36 of 2004, (Republic of South Africa, Financial Services Board, 2004).
- The market for custodial and settlement services relating to securities. In this market there are currently six CSDP's, but the market is overwhelming controlled by the four major banks, as they are the primary CSDP's. Of these six, only one, namely Computershare, participates also as a transfer secretary.
- The third and final market is the market for the provision of share registry services (Kruse, 2005).

1.2 Purpose of this research

The primary purpose or objective with this paper can therefore be seen as to research as well as investigate the question if STRATE can be seen as both regulator as well as a service provider to all the issuers in the share industry.
The Financial Services Board (FSB), in line with its self-regulation objectives, has allocated this responsibility to STRATE. STRATE's challenge is to create heightened awareness for his role. In addition, it must entrench the benefits of effective regulation in a market that previously lacked discipline – a lack that has negatively impacted the international investment environment. As the regulator of the CSDP's, STRATE is responsible for certainty of market transactions and has a statutory and contractual duty to protect the records of the investor in the electronic environment. Investors are hereby assured that all business processes associated with electronic settlements are properly regulated; that inefficiencies and risks are minimized.
STRATE has adopted a risk-based approach to its regulatory responsibilities. Thus, every entity operating within the STRATE environment is obliged to carry and manage certain risks. These are inherent in the role that they each perform in the settlement process and required a heightened level of understanding and pro-activity to ensure that such risks are not aggregated. The accompanying matrix highlights seven broad risk categories and the dominant carriers of each.

Table 1. **STRATE's Risk Matrix**

RISK	**STRATE**	**Settlement Authority**	**CSDP's**	**BROKERS**
Principal	NO	NO	YES	YES
Tainted Scrip	NO	NO	YES	YES
Settlement/replacement Price	NO	YES T+O to final confirmation	YES from final confirmation	YES T+O to final confirmation
Credit	NO	YES	YES	YES
Liquidity	NO	YES	YES	YES
Systematic	YES	YES	YES	YES
Operational/Technological	YES	YES	YES	YES

Source: STRATE. 2004: *Risk Mitigation in the STRATE environment.*

The CSDP's and brokers carry the bulk of the specific risks, which need to be effectively managed if the market is to avoid undue systematic risk as a result of any consolidation onto STRATE of unmanaged risk at the CSDP level. Herein lays one of STRATE's primary operational obligations. Methodologies have been developed to monitor key CSDP activities on a daily basis to ensure that the CSDP's understanding of risk has been enhanced. In this way and through regular interaction, STRATE strives to ensure that the market as a whole is relieved of unnecessary risk (STRATE, 2004: no page).

This paper focuses also on the ethical side of decision making within the financial services sector as well as whether business decisions are properly structured and focused with the aim of conducting a free and fair market environment.

The detailed effect what this proposed acquisition might have for the whole securities industry would therefore be needed to be investigated further and would fall outside the context of this paper. Further in-depth research as well as more data collection from a wider angle needs to be conducted in order to be able to comment on this at this stage. A few points would thus only be looked at as an outline to how the market sees this at this stage.

1.3 Statement of the problem and sub-problems

A various amount of problems do arrive with this transaction, mainly by how will the market with conjunction to al the various stakeholders react to it as well as to what possible ethical issues are involved here. This will be investigated further.

1.3.1 The positive and/or negatives with this transaction.

A certain positive with this transaction is that with this transaction, there seems to be a direct aim to streamline the securities environment as well as the whole market within the share industry.

A negative might be that the competitive advantage of STRATE as regulating authority competing with the only other registrar, namely Computershare, on information gained from the exercise of its regulatory function, is exacerbated by the fact that Section 33(f) of the Securities Act No. 36 of 2004 entitles STRATE frequent access to the records of Computershare at any time (Republic of South

Africa, Financial Services Board, 2004). This may lead to an unfair advantage by STRATE due to the fact that Computershare holds its records of certificated and uncertificated securities in the same system. STRATE in any event accesses this information on a regular basis when they audit the CSDP in terms of the powers they are granted under the Security Services Act (Kruse, 2005).

1.3.2 Should Financial Sector Regulators be independent?

Regulators and supervisors in nations around the world are charged with managing the health of financial institutions and preserving the stability of the financial system. Financial sector supervision is more rigorous and intensive than supervision in other regulated sectors (Quintyn & Taylor, 2004). The question thus might surface "Who regulates who?" In the US, banks could move from one jurisdiction of Bank supervision to another if they don't "like" their supervisor.

1.3.3 Is there a possibility of conflict of interest with this transaction?

Because conflicts of interest are present in almost all aspects of life, we need to be more precise about those of concern here. Mishkin gives the following description for conflict of interest in financial markets:

"Conflicts of interest arise when a financial service provider, or an agent within such a service provider, has multiple interests that create incentives to act in such a way as to misuse or conceal information needed for the effective functioning of financial markets", (Mishkin, 2003: 222).

1.3.4 When are conflicts of interest a serious problem?

The analysis of conflicts of interest begins normally with the observation that they present their main problem for the financial system when they lead to a decrease in information flows that make it more difficult for the system to solve adverse-selection and moral-hazard problems that can slow the flow of credit or information to parties with productive investment opportunities (Mishkin, 2003).

Mishkin further states that even though a conflict of interest exists, it does not necessarily reduce the flow of information, because the incentives to exploit the conflict of interest may not be very high. Exploitation of a conflict of interest that is

visible to the market will typically result in a decrease in the reputation of the financial firm involved.

Mishkin mentioned also that given the importance of maintaining and enhancing reputation, exploiting the conflict of interest would then decrease the future profitability of the firm, because it will have greater difficulty selling its services in the future, thus creating incentives for the firm to prevent exploitation of the conflict of interest. Research used by Mishkin (2003) showed with evidence surveyed by Crockett et al (2003), suggests that these incentives do work to constrain conflicts of interest in the long run, but the extent to which they are effective in the short run depends on factors such as transparency and incentive structures within firms.

1.3.5 The requirement of competition in a free market economy.

There might be fears in the market that STRATE's move with acquisition of Ultra can be seen as a move to a Consolidated Share Register (CSR), with a possible aim to eliminate competition and eliminate all key players of the industry, starting with all the brokers, with an overall fear of becoming a monopoly.

This paper will try and find out on a very high level, if it is possible to detect any direct fear in the market, relating to this transaction, as well as to whether it might be possible with this transaction to block out any future competition. The position might arise whether STRATE will have an unfair advantage over any competition with the completion of this transaction.

This in itself would therefore also look and explore the needs of the issuers and to see what would be a solution to their requirement for the provision of a real-time online share register attained without the direct involvement of STRATE.

1.4 Definitions

STRATE: This is the shortened name used in the share industry for the central depository for all the equity and bond markets. The full name stands for Share Transactions Totally Electronic. The Johannesburg Securities Exchange (JSE) owns 41% of the shares in STRATE. The four major banks of South Africa and Citibank make up the rest of the shareholding (Von Keyserlingk, 2004).

The main vision of STRATE is to be a global and viable Central Security Depository (CSD), providing a fully integrated asset ownership record and the provider of choice of infrastructure for a unique and diversified range of financial services.

STRATE's core business is to provide clearing, settlement and depository services for any electronic financial instruments, while also providing customers the world over with end to end pragmatic, reliable, state of the art electronic services that facilitate the management of risk.

Regulator: STRATE plays her also a significant role to make sure that the settlement and equity market on the JSE comply with the rules set out by the JSE as well as the Financial Services Board (FSB).

Issuers: Issuers are all the listed companies on the JSE, who issue their share in the South African stock market.

CSR: This relates to the Central Share Register – who is the legal registry of all the listed companies, that's being kept in one place.

CSDP: Central Security Depository Participant – or in other words all the individual depository participants that consolidates into the Central Security Depository (CSD). Currently there are six CSDP's in the SA market, of which only one is not a commercial bank. This CSDP is currently operational at Computershare Ltd, which is an Australian listed financial services company with offices globally.

CSD: Central Security Depository – This relates to the specific function of STRATE. Their main function would therefore be for the consolidation and monitoring of all the individual share transactions that have been processed by all the above-mentioned CSDP's on a day-to-day basis.

Scrip: Documents of Title namely transfer deeds.

Computershare South Africa (Pty) Ltd: Computershare entered the South African market in 1998 having been appointed to carry out the demutualization of Old Mutual. The business of Consolidated Share Registrars and Optimum Registrars were acquired to provide the necessary infrastructure. Computershare offers a comprehensive registry management system, from pre-registration through to complex corporate actions. Furthermore does the share registry system of Computershare further maintain records of company registers in real-time on a single database and caters for all registry services (Computershare, 2005).

Ultra Registrars (Pty) Limited: Ultra Registrars was established in earty 2000 at the request of certain listed companies. This was initiated after the acquisition of

Optimum Registrars and Consolidated Registrars. Ultra Registrars does registry services for listed companies on the JSE by maintaining their share registers (Ultra Registrars, 2005).

Financial Service Board (FSB): The Financial Services Board is a unique independent institution established by statute to oversee the South African Non-Banking Financial Services Industry in the public interest (FSB, 2005).

Demutualisation: Demutualisation is the process of changing corporate structure form a mutual fund company to some other form, such as a limited liability or corporation. This means that mutual and/or life insurance companies convert from policyholder companies to stock companies (Investopedia, 2005). This also means the conversion of certificated share registers to electronic share registers.

Australian Securities and Investment Commission (ASIC): This is the regulator in the Australian Financial Services industry. They enforce and regulate company and financial services laws (ASIC, 2005).

1.5 Delimitation of the study

The transaction whereby STRATE has purchased Ultra Registrars created a very interesting scenario in the South African financial services sector. This acts as a real test in the regulator versus service provider role transfer in this industry, to the extent that a question might be asked as to "who is regulating the regulator"?

The extent to what this paper would be looked at will be discussed shortly.

Due to the fact that this kind of transaction can have a direct implication on all the stakeholders in the share industry, very close care would therefore be taken in order to investigate how they would be directly- as well as indirectly be affected.

This paper would try and compare the current situation as it currently as to what could have happened as well as to what would have been a more ideal situation, benefiting all stakeholders.

1.6 Importance of the study

The importance of this study can be seen in the research and investigation regarding the added values that a CSR or alternative solution would bring to all stakeholders in the South African financial market. The importance of the "big picture" will be looked at as well as how this will change the share transfer industry as a whole.

A further importance of this study would be in looking at what contribution this transaction might have in the analysis of the costs involved in alternative solutions as well as the requirement of stakeholders for a low cost model with the aim to reduce settlement costs and provide a real time online register.
In a recent survey done for Computershare by the company Sales Outsourcing, it was clearly found that there is a definite need to provide listed Companies with a real-time online register, with direct access to it (Scott, 2004). At this moment all the listed Companies receive a register that can be sometimes as much as a month old. This becomes particularly important to issuers when conducting take-overs, for them to be able to communicate with their shareholders on a real-time register, as opposed to a register that could be outdated by one month.
An assumption can thus be made at this stage that any issuer will favour a service provider that could provide them with a real-time register. It is a considerable competitive advantage, should any service provider attain exclusivity in regard to a real-time register, as the additional registry services will automatically be diverted to the service provider that is in the position to provide a real-time register. Prior to the current transaction, no service provider was able to provide a real-time service to an issuer. STRATE was always in a position to provide a real-time service for the dematerialised register. The interesting part here is that at no time did STRATE competed with Computershare, Ultra Registrars or any other service provider, for the provision of this service.

1.7 Outline of the research report

The main purpose of this paper would therefore be to try and see the effect this transaction may have on the whole share transfer industry, with the main focus on free and fair business practice with proper controls and regulatory aspects in place. A correlation would therefore be made to try and see how other Security Exchanges around the world adapted themselves to transactions like this, with a look at how regulatory issues are being addressed in their different environments.
The issue whether there might be a conflict of interest would also being looked at in conjunction on how the market sees this transaction as a whole. A detailed discussion would be made on what kind of qualitative research method will be used as well as the specific results achieved with the research. The final discussion on the

research would be based on the findings of the results in conjunction with the correlations that could be made with the literature reviews.

Chapter 2: Foundation of the study

According to a press release dated 6 June 2005, STRATE will acquire 50.4% of Ultra Registrars for an undisclosed amount and the newly formed entity will be housed in a legal entity named Eyethu Registrars (Pty) Limited (Shezi, 2005). There is obviously nothing wrong with the idea of buying out a service provider within the share transfer industry. The biggest question that can be asked by any of the stakeholders in this environment is how this all would affect the existing market as well as to whether it is possible for STRATE to become direct competition within the market he directly regulate on a day to day basis?

There are obviously various scenarios that can be looked at in order to be able to make the right conclusion regarding the acquisition as well as to whether any recommendations can be levelled regarding the whole subsequent change in the market.

2.1 The Market at which the research will look at.

In chapter one it was mentioned that the whole market concise of three major areas within the securities environment. Before the acquisition, STRATE's only role was in the first market, where their main role was to consolidate the holdings of shares by playing the role as the CSD.

The second market is the market for custodial end settlement services relating to securities. The market consists of the six CSDP's who closely monitored and transact the buying as well as selling of shares. Every settlement that takes place are therefore closely monitored as well as audited and uploaded into STRATE. The last market is therefore the market for the provision of share registry services. These registry services can be broken up into various components. These components consist of the following:

- Share Secretarial Services – These services constitutes the holding of the share register in respect of certificated shareholders and the total of the aggregate number of shares held in dematerialised or uncertificated form.

Detailed records in respect of dematerialised shareholders are then held in the sub register operated by all the various CSDP's.

- The amendment of the register – The original function of this action was eliminated years ago by the introduction of STRATE. All the different share transfers are now affected within this electronic sub-register within the various CSDP's and not by their specific transfer secretary. STRATE's key function starts here with the downloading on a monthly basis of all the relevant information received from all the various CSDP's as well as with the sending out of this download to the respective transfer secretaries. This download enables the transfer secretaries to hold a full register of all the relevant listed Companies listed on the JSE.
- Corporate Actions – These activities all include correspondence, payment of dividends to all the relevant shareholders as well as various other communications that might take place between an issuing company and all of its shareholders. Up to now, there were only two parties that can provide this service to all the issuing companies listed on the JSE. These companies had to be registered transfer secretaries, being Computershare and Ultra Registrars. These two companies can provide to all the issuing companies all the relevant information relating to the certificated environment through their own records, as well as all the relevant information in the dematerialised environment through the download they receive form STRATE on a monthly basis (Kruse, 2005).

2.2 The first change in the Market.

The above three markets are currently being serviced by the two and only two transfer secretaries, namely Computershare and Ultra Registrars, the six CSDP's and lastly but not the least the role that STRATE plays as the CSD, duly licensed in terms of Section 32 of the Security Services Act, no. 36 of 2004 (Republic of South Africa, Financial Services Board, 2004).

The first initial change in the securities market happened with the inception of STRATE, as mentioned earlier. The next big change occurred during the taken over of Mercantile Registrars at the 2nd of April 2002 by the Australian listed Company, Computershare (Ultra Registrars, 2005). During that time was Ultra Registrars 45%

owned by Mercantile Registrars. As part of the ruling by the Competition Commission, it was stated that in order for Computershare to be able to take over Mercantile Registrars, as Computershare forced to sell the 45% shareholding Mercantile had in Ultra, to the original 55% shareholding of Ultra Registrars (Republic of South Africa, Competition Commission, 2002). The main reason behind the ruling was to be able to make sure that the market will not be taken over by one entity or group of companies, but to create a market that is still very much competitive with the option to all listed companies to be able to have the benefit of choice when choosing a transfer secretary. From that day onwards was it possible for all the listed companies to be able to have a choice between the two transfer secretaries for their certificated share records.

From a business perspective the acquisition of Ultra Registrars by STRATE makes it now even more interesting. STRATE, in fulfilling their regulatory function, is the only entity that has access to all the information, at any given time, pertaining to dematerialised shareholding. It is thus the only entity that can provide a real time registry to the issuers in respect of dematerialised shareholding. They lack, however, the ability to provide information relating to the certificated environment as Ultra Registrars and Computershare control this environment as the only major transfer secretaries in the market. Ultra Registrars and Computershare, having lost their traditional markets through the statutory dematerialisation process, have focussed on providing issuing companies with share registry services, as defined herein above, in order to substitute the loss of income resulting from the loss of their traditional markets. However, it was very clear as from the beginning that Ultra Registrars and Computershare were always extremely vulnerable, as they always feared that STRATE would utilise the information gained from the exercise of their regulatory function to compete against them in the market for registry services. Well aware of their vulnerability to the possible misuse of STRATE with the information gained through the exercise of their regulatory function, have subsequently forced Computershare to consistently attempt to improve its service to their relevant issuing companies (Kruse, 2005).

2.3 The creation of a new product.

Computershare, recognizing the competitive advantage of providing a real-time service, created a product that will provide such a service. However, in order to give effect to the product, it required the co-operation of STRATE in order for them to supply the relevant information that Computershare would be needed, in time. Computershare, recognizing the competitive advantage of providing a real-time service, created a product that will provide such a service. However, in order to give effect to the product, Computershare required the co-operation of STRATE as mentioned earlier, with the regular deliverance of information more that once a month. Prior to and during the month of February 2004, Computershare approached STRATE with a presentation in which their proposed product was introduced to STRATE. On the 26th of May 2004, STRATE advised Computershare in an e-mail as follows:

"The STRATE management team have reconsidered your proposal and we confirm that for a number of strategic- and practical reasons, we do not believe that it could be appropriate for us to become directly involved in this initiative at this particular time" (Kruse, 2005:12).

These "strategic reasons" would therefore form the basis of this research, in order to be able to try and address what the reasons could be behind the strategic move with the acquisition of Ultra Registrars by STRATE. A direct assumption was therefore made by the researcher at this specific point these "strategic reasons" might have been that they had the acquisition of Ultra Registrars already in mind at the time of the rejection of Computershare's proposal (Kruse, 2005).

2.4 The purpose of the transaction.

The clear purpose of the transaction is to be able to provide issuing companies with a real-time register, thereby monopolising for STRATE the market for registry services. This is very evident from a media release on the 6th of June 2005, explaining the transaction as well as a transcript of the interview with Monica Singer, current CEO of STRATE, by Moneyweb on the 6th of June 2005 (RSG, 2005). The specific media release stated as follows:

"The rationale for the acquisition was to allow STRATE to diversify its income streams with Eyethu Registrars, providing listed companies with end to end efficient and reliable products for all its shareholders" (Shezi, 2005: 18)

She further stated:

"On average, more than 75% of the illegible securities listed on the JSE are now held in dematerialised form within STRATE and it makes economic sense for STRATE to ensure access to the balance and to provide the issuers that choose Eyethu Registrars with an all inclusive effective product and service range. Eyethu Registrars will continue providing efficient and reliable investor services that have become the hallmark of Ultra Registrars and the introduction of complimentary services for issuers and investors were facilitated by STRATE's involvement as a shareholder" (Shezi, 2005: 18).

During the Moneyweb interview, Singer had the following to say:

"We have all our listed companies in our books as our clients. The only area where we service them is in the area where the investor has decided to move the shares into the STRATE environment, meaning, they are not holding share certificates... so we hold the record of all investors in the country. Well, we don't hold the record of the investors but we have a record of the total holding that is dematerialised in STRATE ... now the logic is that if you are a listed company you do not want this proliferation of service providers. You would like to be able to have on service provider for all your needs. As we know, in terms of a company, the investor and the listed company have to provide services to the investor in terms of the statement of account, the dividends, the corporate actions and your financial statements. All these services will always been required whether or not the investor has dematerialised the shares.
So the listed company has, at the moment, to deal with STRATE, has to deal with other registrars that look after the certificated registrar. You know the record of what the investors are holding in paper. Other, sometimes service providers for lets say, managing an annual general meeting, have differant service providers, sometime let's say a dividend reinvestment plan or share option scheme. So it becomes a fruit salad of service providers that listed companies have had to use since the

introduction of STRATE. So the transaction that we are proposing is by creating this registrar company is that the listed companies can then employ the registrar company and then get one service provider for all their needs" (RSG, 2005).

2.5 Matters of great concern.

The following statement of great concern to other service providers in the securities environment during the Moneyweb interview was as follows:

"We have a requirement to give listed companies every month, the record of what is being held in STRATE, in the dematerialised environment. We give this to the transfer secretaries, meaning Computershare and Ultra, for free, we don't charge for that service. That service will carry on as of now. ... We are here to serve the market. The market has not being able to get the service that it requires" (RSG, 2005).

The opinion of what this may entails for the market will therefore be looked at further during the rest of the research, as well as what this may mean in relation to how a free market operates as well as many possible issues relating to the existence of any conflict of interests or any possible unethical business practice in conjunction with any further strategic decisions.

It is therefore very clear through the above mentioned press releases that STRATE envisages supplying transfer secretaries, being now only Computershare, with a download of data on a monthly basis and through Ultra Registrars offers a real-time service identically to the initial product that Computershare have proposed through to STRATE, of which they initially refused to assist Computershare with.

This paper would therefore investigate further whether the above happenings might eliminate competition and become a monopoly an all the markets in a very short space in time.

Chapter 3: Literature Review

3.1 Should Financial Sector Regulators be independent?

Increasingly, both policymakers and policy analysts are recognizing the need to shield financial sector regulators from political pressure to improve the quality of regulation and supervision with the ultimate goal of preventing financial crises. It is surprising though that few analyses have systematically discussed why independence for the financial regulatory agency might be desirable and how it might best be achieved.

When looking at regulators and supervisors in nations around the world, it was found that they are charged with managing the health and preserving the stability of the financial system (Quintyn & Taylor, 2003).

3.2 The rationale for regulation.

Governments regulate financial institutions for two main purposes:

- The first is for consumer protection. This is more or less the same reason they regulate public utilities and telecommunications: to provide a framework of rules that can help prevent the excesses and failures of a market left entirely to its own devices.
- Secondly, regulation in the financial sector has the additional goal of maintaining financial stability as well as a clear public good that justifies a more elaborate framework of regulation and supervision.

Quintyn & Taylor (2004: 2) further mentioned in his research that financial sector supervision, in particular, is more rigorous and intensive that supervision in other regulated sectors. He further mentioned that the lack of independence worsens financial crises. It was found that during many of these recent financial crises, policymakers in the countries affected have sought to intervene in the work of regulators, often with disastrous results. It is therefore now increasingly recognized that political meddling has consistently caused or worsened financial instability. This highlighted very strongly here that the call for a regulator in any sector to be totally independent. It can therefore be aimed that the two main regulators, namely STRATE and the FSB, within the share transfer industry, or in other words, the

securities environment to be totally independent and to rigorously keep their focus on monitoring and regulating this industry as a whole.

Independent regulatory agencies have potential problems of their own. The research used by Quintyn & Taylor (2004) regarding independence, shows that the seminal article in 1971 by the Nobel Prize winning economist George J. Stigler, pointed out that these agencies tend to respond to the wishes of the best-organized interest groups. He mentioned that when regulators are free form political control, the risk of "regulatory capture" by other groups - in particular, the industry they regulate – grows.
Agency independence entails another important concern, namely, the need for accountability. It was stated that an independent agency might pursue an agenda of its own, going against the wishes of the political majority. Some worried analysts have branded independent regulators "the fourth branch of government," implying that they are outside the control of the traditional three branches that keep mature democratic systems in equilibrium through a system of checks and balances. It seems as if some of those fears are exaggerated, they nevertheless demonstrate the need for proper forms of accountability to balance the advantages of agency independence with the disadvantages.

Achieving both political independence and independence from the regulated industry, as well as accountability, is very essential. Political independence, however, remains the prime concern from the point of view of financial stability, given the vested interests that many national governments still have in the banking and overall financial services industry, within specifically the bank regulation and supervision, as well as the dismal track record of political interference in regulatory and supervisory arrangements.

3.3 The four dimensions of independence.

The following can be regard as a basic framework on how regulators in the financial services industry need to focus on as well as on how to remain accountable and regain their respect in the eyes of the many stakeholders involved in this industry.

The key area of focus would obviously be on the aim to be regard as well as seen to be totally independent.

In passing the laws that create regulatory agencies, politicians properly set and define regulatory and supervisory goals. But once those laws are in force, regulators must be free to determine how to achieve these goals – as well as that they should be held accountable if they fail to achieve them. Quintyn & Taylor (2004) have designed and build the following dimension model of independence:

- *Regulatory independence* in the financial sector means that regulators have wide autonomy in setting, at a minimum, prudential rules and regulations that follow from the special nature of financial intermediation. These rules and regulations concern the practices that financial institutions must adopt to maintain their safety and stability, including minimum capital adequacy ratios, exposure limits and loan provisioning. Regulators who are able to set these rules independently are more likely to be motivated to enforce them. They are also able to adapt the rules quickly and flexibly in response to changing conditions in the global marketplace without having to go through a lengthy, high-pressure political process.
- *Supervisory independence* is extremely crucial in the financial sector. It is therefore also difficult to establish and guarantee. Supervisors will have to work closely with financial institutions, not only inspecting and monitoring them but also enforcing sanctions and even revoking licenses. Much of their activity takes place outside direct public view and interference with their work, either by politicians or by the industry, cab be subtle and can take many forms. Crafting a rules-based system of sanctions and interventions also lessens the scope for supervisory discretion – and thus for political and industry interference. Independent supervisors, not a government agency or minister, should be given sole authority to grant and withdraw license because they best understand the financial sector's proper composition – and because the threat to revoke a license is a powerful supervisory tool.
- *Institutional Independence*, or the agency's status outside the executive and legislative branches of government, has three critical elements. Firstly, senior personnel should enjoy security of tenure: clear rules, ideally involving two government bodies, must govern their appointment and especially, their dismissal. Secondly, the agency's governance structure should consist of

multimember commissions composed of experts and thirdly, should decision making be open and transparent to the extent consistent with commercial confidentiality, enabling both the public and the industry to scrutinize regulatory decisions.

- *Budgetary independence* depends primarily on the role of the executive or legislative branch in determining the agency's budget and how it is used. Supervisors should not be subjected to political pressure through the budget. Senior personnel should have the budgetary freedom to staff the agency as they see fit and to respond quickly to emerging agency needs. If funding must come from the government budget, the supervisory budget should be proposed and justified by the agency itself, following objective criteria related to developments in the market. Some supervisory agencies are funded through industry fees, a practice that minimizes political interference but risks increasing dependence on – and attracting interference from the industry. The agency and the government, if used, should determine industry fees, jointly. Also, fee-based funding may leave the agency strapped for funds during a crisis, because that is precisely when the industry is most likely to have difficulty paying the fee. Agencies should therefore be allowed to build up reserve funds as insurance.

3.4 Having "checks and balances" in place.

Having a proper system of "checks and balances" in place is extremely important according to Quintyn & Taylor (2004). It is mentioned that national political culture can also determine whether a country is able to achieve regulatory and supervisory independence. In many Western countries, long-standing political institutions such as a transparent political process, a system of constitutional "checks and balances" and a free press support regulatory independence. But many other economies around the world still lack some of the institutions that would provide a secure basis for regulatory independence.

The parallel with financial regulatory agencies is straightforward, although it cannot yet be tested extensively because few independent agencies do exists. However, studies so far done by Quintyn & Taylor (2004) show that "checks and balances" tend

to insulate financial sector supervisors and to encourage better and more prudent regulation.

Although regulatory and supervisory independence is most effective in a nurturing political culture, such cultures need time to take root. Countries whose political systems lack proper "checks and balances" must therefore base their commitment to regulatory independence on the need to adhere to best international standards and practices in todays globalise system.

In countries with longer traditions of independent agencies or regulators, the evidence conducted by Quintyn & Taylor (2004), suggests that independent regulators typically do not behave as an irresponsible "fourth branch of government." Indeed, it was found that regulators usually behave according to a kind of "dialogue model," doing their best to be informed about the intentions, wishes and opinions of the political leadership and to anticipate their reactions to new policy proposals. In other words, independent regulators remain subject to some form of political control – a type of self-censorship, as it were.

By comparing all these relevant statements as well as analysing all the above research that have been done, it is not difficult to see that it is very critical that a regulator in the financial services environment, definitely have to be independent with its core focus to be the role as regulator to all the other service providers in the same industry. Due to the independence of the regulator in the specific industry, is it therefore very clear that it would be difficult, with an almost impossibility to be able to be effective as a regulator as well as a service provider. There is a definite clashing of roles if that would be the case.

The case for regulatory independence in the financial sector can be based on analogies with two areas where the issue of regulatory independence has already been largely settled by looking at what happened with the regulation of public utilities and telecommunications in the States as well as the conduct of monetary policy by the central bank. Mounting evidence therefore indicates that independent regulators have increased the efficiency and effectiveness of regulation and helped markets operate more smoothly and efficiently.

3.5 Competition law and policy in South Africa.

One of the elements of South Africa's peaceful revolution over the last decade was reform of its competition policy institutions. The previous system had supported the previous economic system, characterised by autarky, protection, government direction and high concentration.

The new system promised to use competition policy to correct the faults of the old system and to promote policy goals of employment and empowerment. South Africa aspires to a modern competition policy regime, to deal with well-resourced sophistication of much of the South African economy. Its new institutions, whose novelty responds in large part of the post – 1994 imperative for fundamental restructuring of government institutions, have shown a capacity to deal confidently with complex structural issues in deciding dozens of merger cases. A legalistic business and government culture has challenged these new bodies to prove their competence and tested their jurisdiction.

Now that the merger review process has been established, more attention should be paid to non-merger matters and probably to advocacy as well. Resources are stretched and there is a critical need to improve the depth and strengthen the capacity of the professional staff. Maintaining consistent competition policy in regulated sectors will require reinforcing the relationships with sectored regulators (Burgeat, 2003).

The 1955 competition law was cautious and permissive. It defined and controlled a number of "monopolistic conditions," that is, potentially anti-competitive practices. None of these practices was prohibited per se. Instead, the law provided for an administrative process to examine particular cases and recommend action. The standard of analysis was simply the "public interest." The Board of Trade and Industry was charged with investigating conduct, recommending remedies as well as negotiating and supervising compliance. Its decisions could be appealed to a special court. But the board had no independent powers, either in investigation or relief. Rather, the Minister of Trade and Industry decided what was to be investigated and what relief, if any, would be applied. The law's remedies and sanctions were prospective only, such as orders to withdraw from restrictive agreements and to correct their consequences. A violation of such an order might be subject to criminal prosecution.

Perhaps recognising that a principal source of monopoly was protection from international competition, one of the law's potential remedies was a request to the Minister of Finance to suspend duties on imports of goods like those involved in the monopolistic condition. The law did not deal with mergers, acquisitions or dominance as such. In theory, the law probably applied to the activities of the state, but such an application would have been unlikely because enforcement depended on Ministerial action (Burgeat, 2003).

3.6 What was wrong with the law?

A commission of enquiry, appointed in 1975, criticised the enforcement system of the 1955 law. Making investigations depend on the Minister's direction subjected enforcement to too much political influence, as well as the Board's roles were in conflict.

The commission of enquiry recommended a new institutional structure that would have followed the UK's "tripartite" system of supervising ministry, a separate "enforcement" body and a more independent decision-making tribunal. Not all of its recommendations were adopted though. The new legislation enacted in 1979, created a Competition Board, appointed by the Minister of Trade and Industry, which could investigate matters on its own initiative. The 1979 law authorised sanctions against anti-competitive mergers and acquisitions and it created a new category of "monopoly situation," determined chiefly by industry structure.

In 1995 the Department of Trade and Industry (DTI) embarked on a three-year project of consultation with experts and stakeholders to develop a new competition policy framework. The result was released in November 1997, as DTI's Proposed Guidelines for Competition Policy, to stimulate public debate about how competition could contribute to restructuring the economy. The proposal described the goal as a more "effective" economy, requiring a better definition of the public interest with respect to firm structures and behaviour. The then-current law did not deal with vertical or conglomerate combinations or ownership concentration and it lacked both pre-merger notification and meaningful post-merger power of control (Burgeat, 2003).

3.7 Primary goals with the Act.

The primary, general purpose, to "promote and maintain competition," is supplemented by six particular sets of goals:

- The first of these is the efficiency, adaptability and development of the economy. This goal corresponds to the DTI interest in a competition policy based on economic analysis.
- The second goal, competitive prices and choices for consumers, recognises the foundation of an economics-based policy in concerns about consumer welfare.
- Employment and social- and economic welfare.
- Opportunities to participate in world markets (and to recognise foreign competition in South Africa).
- Equitable opportunities for Small and Medium Enterprises (SMEs) to participate in the economy.
- Increasing the ownership stakes of historically disadvantaged persons (Burgeat, 2003).

3.8 The rule regarding Horizontal agreements.

The Competition Act's first rule about horizontal restraints is a prohibition based on the rule of reason. Restrictive horizontal practices – that is, agreements, concerted practices or decisions by an association of competitors – are prohibited if they have the effect of substantially lessening or preventing competition in a market. The characterisation of the kinds of arrangements that are prohibited is modelled on terms used in European Union (EU) competition law. The prohibition can be overcome by a showing that pro-competitive gains outweigh the anti-competitive effect, as can be seen in Section 4(1)(a), (Republic of South Africa, Competition Commission, 2001).

3.9 The rule regarding Vertical agreements.

Unlike most competition statutes, which typically group all restrictive practices into a single rule, South Africa's Competition Act separates the rule about restrictive practices between parties in vertical relationship from the rule about horizontal

restraints. The competitive effects of vertical agreements are a lot more complex and thus they are usually assessed under a rule of reason. In jurisdictions where the law prohibits restrictive agreements without distinction, difference in their likely effects must be recognised or developed through enforcement practice of guidelines. Under South Africa's statute, a vertical agreement is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party can prove that any technological, efficiency, or other pro-competitive gain resulting from that agreement outweighs the anti-competitive effect, as can be seen in Section 5(1) of the act (Republic of South Africa, Competition Commission, 2001). Thus finding a violation usually depends on showing an actual anti-competitive effect.

3.10 Possible abuse of dominance.

South Africa's law about single-firm conduct is based on abuse of dominance, but also includes a rule about price discrimination that resembles North American statutes. According to Section 7 of the Act is dominance defined in terms of market share and market power (Republic of South Africa, Competition Commission, 2001). Any firm that actually has market power is considered dominant, regardless of its market share. The definition of market power includes concepts from the EU's definition of dominance: "the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent in dependently of its competitors, customers or suppliers. A firm with a market share of over 45% is conclusively considered dominant. A firm with a market share between 35% and 45% is presumed to be dominant, but the firm may rebut that presumption by showing that it does not have market power. If the firm's share is below 35%, the enforcer has the burden of showing that it has market power.

Abuse of dominance can therefore also be seen as refusing a competitor access to an essential facility (provided that it is economically feasible to grant access). Dominance is defined in terms of particular, defined markets, not in terms of firm size alone. But there is a provision for general exemption based on firm size, evidently to ensure that small firms will not be considered dominant in small markets. The Minister has the power to define a threshold below, which the abuse of dominance prohibitions does not apply.

3.11 Mergers.

The legal standards for merger control are general and evidently permissive. The competition policy standard, which must be assessed firstly, is whether the merger "is likely to substantially prevent or lessen competition." That determination requires a multi-factor analysis, set out in the statute, to assess the probability that firms will compete or co-operate after the merger. According to Section 12(a)(1), of the Act are factors that needed to be considered here competition, ease of entry, tariff and regulatory barriers, concentration, any history of collusion, countervailing power, dynamic characteristics such as growth, innovation, product differentiation, vertical integration, business failure and the removal of an effective competitor (Republic of South Africa, Competition Commission, 2001).

If the competition analysis indicates a problem, the next step is to determine whether technological, efficiency, or other pro-competitive gains would be likely to offset the anti-competitive effects – and would not likely be obtained absent the merger.

A merger may also be approved, or disapproved, based on "substantial public interest grounds." The public interest grounds are very broad, but they are not unlimited, based on the effect it may have on a particular sector or region, employment, the international competitiveness of South African industries, or the ability of small business or firms controlled by historically disadvantaged persons to become competitive.

3.12 What mergers need to be looked at by the Commission?

When looking at Section 11 of the Act, it can clearly be seen that deadlines and procedures differ depending on the magnitude of the specific transaction. Mergers can be classified as small, intermediate, or large, according to thresholds of turnover or assets that are determined by a regulation issued by the DTI, after notice and comment and in consultation with the Commission (Republic of South Africa, Competition Commission, 2001).

The threshold has been increased significantly since 1998 to reduce the number of transactions that are subject to mandatory notification and review. The means, "large mergers" are transactions over R3.5 Billion in combined turnover or assets, as well as over R100 Million for the acquired firm. Small can thus be regarded as transactions below R200 Million in combined turnover of assets and below R30

Million for the acquired firm. Filing fees have also been cut in half to R250,000 for larger mergers and R75,000 for intermediate ones.
Small mergers ordinarily need not to be notified to the Commission. This can therefore be seen as the reason why this proposed transaction, haven't been notified to the Commission, due to the low value of the transaction. The Commission may require notification of a small merger if it believes the merger might have an ant-competitive nature of effect, or that it might not be in the public's best interest for the transaction to go through.
The Commission must take this action within 6 months after the transaction and the parties must suspend implementation until the review is completed. Intermediate and large mergers must be notified in advance to the Competition Commission and notice must be give to the union or employees of the primary acquiring firm as well as the primary target.
The notification package must include a number of documents along with the acquired forms namely: the merger agreement, "a document addressing the transaction with respect to competitive conditions," documents about the transaction prepared for the board of directors, recent annual reports, future business plans and reports to the securities regulator. The parties would therefore typically use the document describing the transaction and competitive conditions to present their case for approval. Pre-existing documents prepared for the firm's board are also supposed to be provided, but they rarely are. This has happened in a case where parties have withheld documents and information that the Commission has requested, only to bring them forward at the Tribunal when that appears necessary to bolster their case. The Commission has found that information submissions with merger filings are often incomplete and increasingly the Commission has been moved to "stop the clock" because the information in the filing is inadequate. The penalty for proceeding with a merger without the acquired approval can be up to 10% of the parties' turnover.

For small and intermediate mergers, the Commission is the principal decision-maker. The Commission have only 20 business days to reach their decision after the notification is completed. The period may be extended once, up to 40 business days, depending on the difficulty and sensitivity of the specific case. If the Commission does not act within the deadline, the merger would be approved immediately. The Commission must publish the reasons for its action if it prohibits a merger or imposes

certain specific conditions – or of the parties' request that it do so, even if the Commission approves if. According to Section 13 of the Act, when looking at large mergers, the Commission must refer the notice to the Tribunal and the Minister of Trade and Industry. Within 40 business days after the notification is completed, the Commission must forward its recommendation. The Tribunal may extend the deadline, 15 business days at a time. If the Commission misses the deadline, the parties may petition the Tribunal to proceed without a proper Commission recommendation. Therefore for a large merger, the Commission's failure to act does not mean that the merger is approved (Republic of South Africa, Competition Commission, 2001).

3.13 Main function of the Tribunal.

The Tribunal is the decision maker about large mergers. The Tribunal may also be asked to decide about small and intermediate mergers in some circumstances. If the Commission prohibits a small or intermediate merger or imposes conditions on it, the parties may ask the Tribunal to consider the conditions of the merger. According to Section 16(1), If the Commission approves an intermediate merger or imposes conditions, the union or employees who were given notice may ask the Tribunal to consider the approval or conditions (but only if they had participated in the Commission's proceedings). In all merger cases, the Tribunal must reach a decision by a deadline, which is set by regulation and it must publish its reasons. For large mergers, there is no "silent is consent" rule (Republic of South Africa, Competition Commission, 2001).

Decisions about public interest issues as well as about competition issues are up to the Commission and the Tribunal. The original draft of the Competition Act would have given the Minister the power to apply the public interest criteria, that is, to override the competition policy decision on those specific grounds. But the Minister, at the time decided to decline that power. When looking at Section 18(1), the Minister may participate as a party before the Commission or the Tribunal in considering intermediate or large mergers, in order to make representations concerning the public interest grounds. In only one sector, banking, is there a provision for ministerial invocation of other policy interests to displace the Competition Act namely: a bank merger may not be subject to the Competition Act notification of review if the Minister

of Finance certifies that it is in the public interest for it to be subject only to the jurisdiction of the Banks Act. Furthermore, when looking at Section 18(2), because of public involvement or regulation does not create an exemption from competition policy, restructuring or privatisation carried out pursuant to government policies, would not be exempted from merger notification and review (Republic of South Africa, Competition Commission, 2001).

The Commission tries to focus its resources by identifying quickly the mergers that are likely to be approved and those that are likely to be problematic. The Commission has offered a "fast track" process in its service standards, set out in a December 2001 memorandum describing the types of transactions that would qualify for this expedited treatment (Burgeat, 2003). Two types that virtually never have competition implications are property transfers and management buy-outs. The Commission will also deal quickly with transaction in which there is a failing firm in which one party is a new entrant. Fast-track treatment is promised if there is no product or geographic market overlap among the specific firms. If the combined share exceeds 15%, fast-track treatment depends on the level of concentration and the magnitude of the increase. The parties must all provide the factual basis for their contentions about the market and the effects and efficiencies and there must be a comfort letter from the unions abjuring an attention to raise issues about employment. For qualified transactions, the Commission undertakes to reach a decision in 20 days. (The actual period must be at least 10 days, because that is how long the Minister has to indicate whether intends to call attention to any public interest issues).

Decisions on larger mergers are often issued on the day of the hearing.

The public interest considerations are independent on those based on competition and efficiency and they are equally important. A merger that raises no competition policy concerns may still be barred because of other public interest considerations. According to the Organisation for Economic Co-operation and Development Peer Review of May 2003 (OECD Review), at least one merger has been permitted only after the parties accepted conditions related to employment security, despite a finding that the transaction raised no competition concerns.

Considerations of the public interest often appear along with arguments about efficiency. The Tribunal has permitted otherwise anti-competitive mergers where there were strong showings of productive efficiencies that would outweigh the anti-

competitive effect. Public interest concerns have been prominent in decisions about others, but they were not necessarily reasons to permit them.

The Competition Appeals Court has implied, though, that public interest factors should not prevent a merger if there are no competition policy reasons to do so.

3.14 Competition Policy in South Africa.

To a surprising extent, competition policy in South Africa is merger policy. Even before the new law was adopted in 1998, the controlling of mergers was the task that occupied most of the competition policy attention. That pattern has continued under the new, stronger control processes. The bar prefers the previous system because it was comparatively informal and very low-key. On the other hand, it was also less transparent. The evident overview of the review obligation that had been imposed by the original thresholds was a matter of some criticism in the business community. The revisions in 2000 to reduce the scope of mandatory filing and that the "fast track" policy adopted in 2001, to focus effort on the most significant transactions, have tried to meet those criticisms. According to the resent work done by the Organisation for Economic Co-operative and Development is that in terms of substantive economic analysis and sensitivity to policy context, merger review in South Africa is done at a very high level of sophistication.

3.15 What have happened elsewhere?

Fundamentally, "front-line" regulatory responsibilities in Australia sit with the market operator. This structure is underpinned with the view that there are real advantages to having a market operator with public regulatory responsibilities that is able to use its closeness to the market to monitor broker activity and to intervene very quickly as required (Lucy, 2004)

The Australian market concise of the Australian Stock Exchange (ASX), as Australia's premier capital market, which first raised the complex set of demutualisation-related issues that can be regarded as more or less the same as of what was experienced in the South African share industry. The ASX experience,

however, has close parallels to the other major market in Australia, namely the Sydney Futures Exchange (SFE).

The ASX operates Australia's primary national stock exchange for equities, options and fixed interest securities. The SFE on the other hand, provides futures and options on the four most actively traded markets namely: interest rates, equities, currencies and commodities and is the 10th largest financial futures and options exchange in the world by volume turnover (ASX, 2004: no page). Both the ASX and SFE are demutualised markets, with the ASX demutualising in 1998 and the SFE in 2000. Both the ASX and SFE are public companies with shares trading on ASX's markets. Both ASX and SFE operate and manage their own clearing and settlement facilities, as well as that both are obvious significant global links. The very interesting part of it all is that neither ASX nor SFE have ownership links with other exchanges.

Furthermore do Australia's share industry have no market participant based Self Regulatory Organisation (SRO) as one may find in other jurisdictions around the world. Rather, it is ASX itself that is responsible for supervision of the market, market participants and market disclosures.

3.16 Demutualisation – the ASX story

According to the research done by Jeffrey Lucy, the Chairman of the Australian Securities and Investment Commission (ASIC), he mentioned in his work in May 2004, that history was made when trading started in ASX shares on the 14th of October 1998 (Lucy, 2004). This was the first time, anywhere in the world, that exchange shares were traded on a market operated by the exchange. 96% of ASX members had voted in favour of demutualising the exchange following a campaign to persuade members that demutualisation was needed if ASX was to survive as a long-term commercial entity and on a larger scale, if Australia was to retain a viable domestic market for securities trading.

The analysis supporting demutualisation stressed that ASX needed to become more flexible, responsive and commercially focussed, capable of quickly taking up emerging commercial opportunities. The mutual structure of ASX, including at least 500 individual members as well as the large global institutional participants, was seen

to inhibit its ability to make rapid commercial decisions to meet emerging business opportunities and threats.
ASX was also focussed on the challenges posed by the global nature of financial market activity and saw that it needed to engage with the global market. However, this could not occur without changing the Australian laws.

3.16.1 The first legislative response.

This was not a complete rewrite of the Australian trading laws, however it did contain some new concepts to name a few:

- Detail on the exchange's obligation for market supervision including an express power to require it to do specific things to ensure it complies with supervisory obligations;
- Requirements that the exchange, at least annually prepare and give to the regulator (ASIC), reports about compliance with their supervisory obligations; and
- Processes to require ASIC to act as the listing authority for ASX – i.e. the role that ASX plays in relation to all other listed entities, as well as to ensure that the ASX as a listed company complies with its disclosure obligations.

Importantly however, at this time there was no legislative basis for regulating conflicts between ASX's commercial interests and its obligations as market supervisor. The only conflict issue the law dealt with related to the ASX itself as a listed entity, not as a commercial rival of another listed entity.
Soon after ASX's listing it became clear that Australia had indeed embarked on an adventurous journey as ASX surged forward with a number of commercial initiatives that gave rise to regulatory challenges. This were more-or-less the exact time where it all got more interesting with ASX's announced takeover bid for the SFE, during the month of December 1998. In May 1999 Computershare, a public listed company on the ASX, announce a rival bid for the SFE (Lucy, 2004).

A major conflict of interest had arisen and the sharp question that the ASIC as regulator have asked was: "What arrangements can we put in place to ensure that the supervision of Computershare as a listed entity is not seen as tainted by the

obvious conflict between ASX's role as a market supervisor and its interests as a potential commercial competitor?"

At that specific moment, did the legislation not dealt with this potential situation and a regulatory response was therefore required. Accordingly, both parties entered into an agreement with ASIC which provided that, until the issue of the rival bids was resolved, ASX would not make any substantive decision about Computershare without consulting ASIC and acting in accordance with the advice provided by ASIC (Lucy, 2004).

3.16.2 The Arrangement and the response from the Market.

This purely contractual arrangement was made public and details released to the market. Incidentally, neither ASX nor Computershare succeeded in their bids and SFE remains independent today.

During the following years since demutualisation, ASX also pursued a number of other domestic business opportunities which could give rise to the conflict, including:

- ASX acquired a 50% interest in a share registry business that competed for registry business with another company listed on ASX (Computershare) including competing for registry business of companies proposing to list on ASX;
- ASX acquired a 100% stake in an investor relations firm;
- An ASX subsidiary, ASX International Services, began operating as a licensed broker listed on the ASX (this is the vehicle through which ASX facilitates its links into the Singapore and US markets); and
- An ASX subsidiary – ASX Futures – was authorised as a futures exchange in direct competition with the SFE (which is also listed on the ASX).

From the above mentioned, at that stage it could be clearly seen that there was a great potential for conflict that was significant. At that stage ASX recognised the Government's concerns. It also recognised the importance of maintaining integrity in its own market, structure and supervisory obligations and during November 2000 they created the ASX Supervisory Review Pty Ltd.

The ASX Supervisory Review is an ASX subsidiary that essentially operates as an arms length "process monitor" and "internal regulatory auditor". Its role is to ensure

the integrity, efficiency and transparency of ASX's supervision of its markets. ASX Supervisory Review distinguishes itself as a supervisory body that is separate form ASX, by having:

- Independent directors;
- A mandate approved by the regulator (ASIC); and
- Reporting on supervision to the regulator (Lucy, 2004).

3.16.3 The Second Legislative Response.

On March 2002, a clearer regulatory environment emerged with the introduction of the *Financial Services Reform Act 2001* in Australia. While the 1st legislative response made assumptions about the activities of the exchanges of Australia, the current legislation makes it a statutory obligation that market operators do all things necessary to ensure that the market is operated in a "fair, orderly and transparent" manner.

The new Australian legislation is still based on a model where the market operator has front line regulatory responsibility. However, it also prescribes that:

- ASIC will undertake an annual assessment of ASX supervision, including by way of public reports;
- Market operators must have in place adequate conflict management arrangements to deal with conflicts between commercial interests and ensuring the market operates fairly and transparently; and
- Single ownership of ASX shares is limited to 15%.

This regulation is very important for the Australian share industry as it allows ASIC to intervene, at the request of a commercial competitor of ASX and to take a supervisory role where there is a specific and significant conflict, or potential conflict, between the commercial interests of ASX (or a subsidiary of ASX) and its market supervision obligations in dealing with a listed entity that is a competitor.

Interestingly, the new legislation has also removed the concept of "exchange" in Australia, such that the key concepts are now of:

- Market operator – being the ASX;

- Clearing and settlement facility provider – in the ASX case, the Australian Settlement and Transfer Corporation (ASTC) which provides settlement services through CHESS and the Australian Clearing House; and
- Financial service provider – the market participants (Lucy, 2004).

3.16.4 Actual Observations and Issues.

The overwhelming experience and evolution that took place during the demutualisation process in Australia had the big effect of quick responses of legislative reform. This has, in turn, seen changes to market supervisory arrangements aimed at maintaining market integrity and the improvement of conflict handling arrangements.
It is therefore very clear from the Australian story, that in an environment of market demutualisation, regulators need to be prepared to quickly respond to conflict and other issues that might arise from the demutualised entity pursuing its own commercial objectives. These issues would not always be obvious in advance and may arise very quickly without prior warning from any of the parties, simply through the pursuit of legitimate commercial opportunities (Lucy, 2004).

Indeed, even in Australia, where considerable efforts have been undertaken by as ASIC, the legislators and the market itself, there remains a potential conflict between the market operator's public role as front-line regulator and its role as a profit driven commercial enterprise seeking to maximise returns for its shareholders.
In its "Issues Paper on Exchange Demutualisation", the IOSCO Technical Committee stated that:
"The commercial role of an exchange is to provide services to generate revenues from listing, trading services, settlement fees, and fees for membership and charges for sale of market information." (International Organisation of Securities Commissions, 2001: 6).

Demutualisation may reduce some conflicts by separating ownership of the exchange from its participants. However all for-profit exchanges with public supervisory responsibilities face the potential for actual or perceived conflict, with

the risk that it may be less willing to commit resources for enforcement, to take action against market users and listed companies, who are a source of income for the exchange.

Accordingly, in determining allocation of its resources, in setting its rules and in undertaking its supervision, a market operator must balance those commercial interests and ensure that it continues to meet its supervisory obligations.

For its part, a market operator will assert that maintaining market reputation and integrity is a key objective to its own commercial success. This at the end of the day has the effect that this commercial imperative compliments its obligation to supervise the conduct of listed companies and participants on the market.

In a paper distributed to the World Federation of Stock Exchanges, Mr Richard G Humphrey AO, Managing Director and Chief Executive Officer of the ASX, stated:

"Our brand, that is to say our reputation and therefore our business and ultimately our very survival, depend on market integrity. Market integrity inspires confidence on the part of investors and listed companies, which in turn encourages further listing and trading activity, forming a virtuous and self-reinforcing cycle.
(Humphrey, 2003: 15).

ASIC, in their role as regulator, accept that ASX's reputation as a market of high integrity is imperative to its long term success and note also that it's commitment to maintaining market integrity must be supported by detailed processes to manage actual and potential conflicts of interest. Generally, these arrangements would also be subject to ongoing review for their effectiveness.
It can therefore be seen that ASIC has welcomed the role of ASX Supervisory Review in managing ASX's potential conflicts of interest and reviewing internal policies and procedures for market supervision.

In the paper done by Lucy (2004), he mentioned that further comments that can be made of a demutualised exchange is that it operates a dual role, that as regulator and that as commercial enterprise. Conflicts will therefore always arise. Conflict

handling arrangements must therefore be embedded in the practices of the organisation's operational structure and must anticipate that conflicts will play out in very much different ways. The example has been used that conflicts may arise between commercial business development considerations and the allocation of resources to supervisory activities. In this example, the allocation of the resources to commercial activities must then be matched by a corresponding focus on supervisory issues and resources.

If an exchange's brand is therefore intrinsically linked to the integrity of the market, it will be in the exchange's business interests to maintain adequate resources for supervision. But in the real world it is easy to focus more on cost centres and direct profits and such a focus is usually to the detriment of functions like compliance and supervision where the benefits are less direct (Lucy, 2004).

Likewise, where emphasis is placed on customer relationship management by staff that also have a day-to-day responsibility for monitoring supervision i.e. enforcing listing rules, it is crucial that such activities do not detract from staff ability or willingness to undertake that supervision appropriately.
Lucy (2004) mentioned further that and appropriate and robust governance arrangements are an extremely important part of ensuring that there are adequate accountability and control systems to make sure that the market continues to meet its supervisory obligations. The Governance structure of a market needs to guarantee independent regulatory thinking and must have a structure that reflects and encourage this. Indeed, it is vital that an operator has in place appropriate formal structure for monitoring, testing and reviewing its own compliance with it obligations to supervise its market, including assessing how well it is delivering a fair, orderly and transparent market. That is furthermore also important that senior management and ultimately the Board of such an organisation, is able to satisfy itself that it will to comply with these supervisory obligations.

A structural separation of supervisory and commercial roles would further enhance supervisory independence and would generally be supported by:

- Quarantining information between commercial and supervisory areas;

- Use of internal management reports that identify incidents or exceptions to compliance with a market operator's obligations to supervise

The ASX have therefore restructures its supervisory activities by creating a single division that is now responsible for managing and administering all of ASX's core supervisory activities. The effect is that there is now only overlap at the CEO / Board level.

In his work, Lucy (2004) finally mentioned and make the conclusion that while many in the regulatory community may have pondered the regulatory role of the exchange, he mentioned that he firmly believe that the Australian experience suggests that when the market operator recognises and safeguards the integrity of the market, front-line public regulatory responsibilities can appropriately sit within the market operator (Lucy, 2004).

3.17 Responsibility for Ethics.

Another way of looking at what have happened in Australia and that what might have been happening in the share- or securities industry, the way of analysing the transactions or proposed transactions, is to look at it from the responsible side of Business Ethics.

The following model will show the different layers of responsibility of ethics there may be. They would form the core part in addressing all business decisions when looking at them from an ethical perspective.

The layers of responsibility for ethics are depicted in Figure 1. True market reform requires self-imposed control in the top layer – individual action – where the issue is whether conduct is ethical, not whether it is ethical. When all the systems are installed at each level, we are ultimately dependent on individuals to exercise ethical courage and leadership in their companies and the big industry. Big-name lawyers as compliance chiefs and management consulting firms creating ethics programs are not substitutes for individuals with ethical spines (Jennings, 2005).

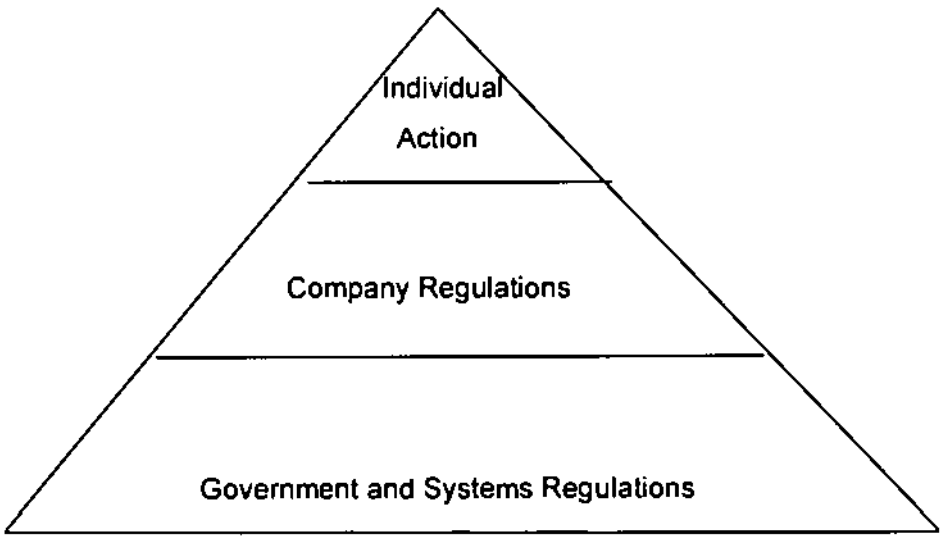


Figure 1

3.18 Criticality of Corporate Governance for the Finance Sector.

The crises' that were experienced in the financial sectors of a few emerging markets as of late, have proved how increasingly sensitive and volatile this sector can be. The unending research on the causes of these crises have indicated the coexistence of (if not causation by) poor governance structures and systems contributing to lack of transparency and exploitation of conflicts of interest. Corporate governance in this sector has assumed importance at public policy level due to the increasing possibilities of systematic risks and a contagion that may transcend classes of institutions.

In a study done by Reddy (2004), he found that governance in this sector is known to pose a special problem due to three other reasons:

- Firstly, the activities of financial institutions and/or service providers are opaque, particularly in the banking sector. Unlike in the product and other services markets the exchange is not immediate and discernable.
- Secondly, most assets in the financial sector are relatively liquid.
- Thirdly, there are serious information asymmetries, which get aggravated with the coordinated issues among equity and debt holders that in turn intensify the agency problem.

Reddy (2004) found that the quality of corporate governance is a function of the quality of the overall control architecture. Control architecture may be defined as a framework or grid that provokes and canalises behaviours of various players within the system.

The framework consists of regulators, government, institutions such as stock exchanges, judiciary, enforcement agencies, shareholders meetings and the Boards i.e.: all those that determine the macro-conditions relative to regulation, legal infrastructure, informational infrastructure and market infrastructure as well as the bodies implicit in law relating to joint stock companies. There is no uniquely good control architecture, despite the popular conception of the "outsider" / market model advanced by researchers particularly of the World Bank. He further mentioned that at the same time, there is no other robust framework that can be used as an international standard. Thus, the control architecture has to be uniquely adapted to the economic and developmental contexts of the country and is steered gradually and sensitively.

Corporate governance literature has popularly advocated the benefits of private ownership of financial institutions and how government ownership can induce inefficiency, politically directed inappropriate lending; conflicts of interest between the bureaucrats and the managers; conflicts of interest between the regulators and the regulated; abuse of office and lastly corruption. Reddy (2004) have found that research is being cited to show as to how government ownership weakens incentives and curtails competition while tolerating inefficient government directives as well as political patronage.

In developing countries, the regulator than the market – not because of opacity and information problems but due to insufficient development of the domestic market for control exercises "contestability" more. The number of potential predators is very few, the transaction costs are high and the process is also time consuming. On the other hand, regulation may continue to be the most important instrument in this architecture both for good governance as well as gradual development of other mechanisms such as competition. As perfect competition and perfect markets are indeed utopian for the developing countries, it becomes axiomatic for regulators to manage the architecture of controls in such a manner that markets develop robustly and naturally.

The other challenge has been to sensitise and manage conflicts of interest, which have particular importance in the financial sector. For reasons of opacity, informational asymmetry and aggravated agency issues, the scope for profiteering form conflicts of interest are enormous.
Research used by Reddy (2004) regarding Corporate Governance, shows that the indicators formulated by Crockett (2004) regarding conflict of interest which has been recognised in basically four areas i.e. "underwriting and research in investment banking; auditing and consulting in accounting firms; credit assessment and consulting in rating agencies and the universal banking sector." In this work Crockett (2004) defines conflicts of interest as follows: "Conflicts of interest arise when a financial service provider, has multiple interest which create incentives to act in such a way as to misuse or conceal information needed for the effective functioning of financial markets".

3.19 The nine remedies for managing conflicts of interest in the Finance Sector.

Crockett and others have recommended the following nine remedies for managing conflicts of interest in the financial services industry:

- Increase disclosure for investment analyst, credit rating analyst and auditors to reveal any interest they have in the firms they analyse;
- Improve Corporate Governance to control conflicts of interest, ensuring that auditors are responsible to shareholders and not managers;
- Increased supervisory oversight over conflicts of interest;
- Provide adequate resources to supervisors to monitor conflicts of interest;
- Establish best practices, codes of conduct to control conflicts of interest, devised by industry and supervisors in cooperation;
- Enhance competitiveness in the rating agency industry;
- Prevent cooption of private information producing agents by regulators and supervisors;
- Avoid the forced separation of financial service activities except in unusual circumstances;
- Avoid the socialisation of information in the financial service industry in most circumstances.

In developing- or in other words, emerging countries, Reddy (2004) mentioned that there are other conflicts of interest that needs very close examination, i.e.:

- Conflicts among asset management companies, trustees, research/advisory service providers and clients.
- Conflicts of interest within the insurance companies.
- Conflicts of interest among directors that lead to connect lending, self-dealing, related party transactions, etc.
- Ownership of equity by regulators and the employment of regulators by the private sector.
- Conflicts of interest between Government, bureaucracy and regulators (regulators independence and governance of regulatory bodies has been an issue among several developing countries).

When looking at all the happenings in the market, a clear direct connection can therefore be made where some of the above happenings occur in the transaction mentioned earlier with ASX and Computershare in Australia. Even though it was not clearly stated, one could easily see the conflict of interest that actually did arise there due to the ownership of equity by regulators as well as the employment of regulators by the private sector, to name one.

3.20 What can developing Countries like South Africa do about this?

Reddy (2004) found that there are regulatory overlaps/gaps as also laws that do not support the popular expectations for good corporate governance. These may accentuate conflicts of interest, regulatory arbitrage and the exploitation of legal lacunae to perpetuate poor standards of governance. In the sum, conflict of interest cannot be eliminated fully. However, proactive measures by the government and regulators by establishing norms for separation of functions/activities; supervisory oversight and mandatory disclosure are probably more appropriate for the developing economies which cannot as yet hope for market imposed discipline.
Corporate governance therefore revolve around the following challenges namely; information flow and conflicts of interest. While the efforts of the multilateral and international organisations are very helpful in establishing the structures, standards and flow of information, the challenge for developing countries continues to be those

of actual changes in practices and of capacity to use this information meaningfully. At the same time, conflicts of interest exist particularly in four areas and these can be resolved through a combination of approaches. Of these, it is probable that developing countries will have to continue to rely on structural separation of functions and activities; supervisory oversight; as well as mandatory disclosures in that order of priority, as market discipline is still a distant possibility.

3.21 A view at happenings in the United States Market.

In recent years, there has been a considerable interest in whether commercial bank powers in the United States (U.S.) should be extended. According to Rajan (1995), did the economic debate revolved around three questions:

- Firstly, whether banks be more, or less efficient than existing producers when they provide the proposed service/
- Secondly, will the extension of banking powers affect the stability of the financial system?
- Thirdly, should the government be in the business of setting limits on bank activities?

Rajan (1995) found that it is not often recognised that the debate in the U.S. takes place in a country that has perhaps the most sophisticated financial system in the world. In this system, commercial banks coexist with liquid financial markets, extensive information gathering and certifying agencies, a tried and tested regulatory apparatus, strong reputable firms as well as a democratic political system with substantial checks and balances in place.

Rajan (1995) further found some arguments for allowing (prohibiting) banks into (from) the securities business are important because they have intrinsic merit. Others have gained popularity (and hence importance) because they seem to have undeniable merit when viewed from the perspective of undergraduate economics i.e. in a world where most technologies and markets are competitive and information is publicly and freely available. While this may indeed approximate reality in the U.S., it is not at all obvious that it does in other countries.

In the U.S. the securities business have always been viewed as businesses just generating profits. In research done by Hayes and Spence (1983), they found

evidence that security firms have market power in the United States. Presumably in less developed economies, security firms may have even greater market power. But it does not immediately follow that the entry of commercial banks into business will make financing more competitive.

3.22 Conflict of Interest in Security Underwriting in the UK.

The biggest hurdle that was experienced in the UK Securities Industry was the concern of the possible conflict of interest a bank or any financial institution faces when it is allowed to both lend to as well as underwrite for a company. The biggest question that can be raised here is whether a commercial bank is exploiting its role as lender and underwriter to force a company to issue public securities and use the proceeds to repay the bank loan. The bank may therefore indirectly shift the risk of a bad loan from itself to the market Hebb (2000).
The dual role of lender as well as underwriter can therefore be clearly identified. The same question can therefore also be asked within the South African industry: Is it possible being a regulator and service provider in the same industry?

3.23 What lead to the concern for Conflict of Interest in the Financial Services?

The Glass-Steagall Act was passed in 1933 during the Great Depression. The nation's banking system was at that stage in serious chaos. Over 11,000 banks had failed or had to merge, reducing the number by 40%. Many brokers and bankers were guilty of disreputable and dishonest dealings and gross abuses of the investors' trust. The purpose of the Glass-Steagall Act at that stage was to limit banks to conservative commercial lending and to prohibit riskier undertakings. To accomplish this policy, Congress prohibited banks from having interlocking directorships or close officer or employee relationships with a firm "principally engaged" in securities underwriting and distribution (Wells, 1999).

Over the next sixty years plus many of the provisions of Glass-Steagall were gradually eroded. However, the provision separating commercial banking and investment banking remained intact until Citigroup brought this era to an end when it merged with Travellers. This merger was boldly announces while Glass-Steagall was

still in effect and the intense lobbying that followed forced Congress to allow it. Glass-Steagall's death warrant was sealed when the Fed allowed the new Citigroup five years to shed its illegal aspects. Congress passed the Gramm-Leach-Bliley Act in 1999. This Act also became known as the Financial Services Modernization Act.

According to the Congressional Research Service (CSR), was the Gramm-Leach-Bliley Act intended to "modernize the delivery of financial services to customers by changing the regulatory structure of financial service providers and rationalizing some of the ways in which they do business" (Wells, 1999).
Central to the Act are those provisions that repealed portions of the Glass-Steagall Act and the Bank Holding Act of 1956 so as to permit affiliations among banks, security firms and insurance companies. Congress knew this was not the end of the issue and it delegated the task of developing new regulations. CRS noted that success hinged on how the regulators would write the regulations and how financial service providers and users of financial services would respond to the new opportunities. In his work, Wells (1999) mentioned the following: "As experience with the Act evolves, it is likely that some fine-tuning of its provisions may result".

Announcements such as a merger or an earnings announcement are a single identifiable event and therefore produce a single and short event window (Lamdin, 2001). For regulatory changes, there is a less precise event window. Regulatory changes are proposed, debated and ultimately resolved when the change was enacted or defeated.

In a resent study done by Sitignano (2004), it was found that preventing conflicts of interest through additional regulations might also help the industry. Before the news landed on the front pages of newspapers, investment banks or institutions were engaged in a race toward the bottom. Financial Service A or Bank A knew that Financial Service B or Bank B would do anything to win the next big merger or acquisition (M & A) deal or initial public offering (IPO). To remain competitive, A needed to "cheat" just to stay competitive. As such everyone was "cheating" and amongst the larger investment banks that vie for the same business, did not offer a competitive advantage.

Sitignano (2004) further found that there could be always a risk of over regulating the industry. While there must be rules and regulations to prevent egregious examples of fraud, it must be said that investment-banking firms must be allowed to play their critical role in capital markets and globalisation.

Conflicts of interest are built into the structure of our financial institutions because they typically provide multiple services to multiple clients. Although some conflicts can be reduced, the cost of doing so is often less than the benefit of having large, comprehensive financial institutions. The main challenge in the financial services industry, therefore, is to manage conflicts by such means as adequate disclosure and effective rules and policies (Boatright, 2001).

In the research done by Boatright (2001) regarding Conflicts of Interest in Financial Services, he is building on a distinction made by Kevin McMunigal (2001) between two kinds of conflict of interest rules in the legal profession, namely rules for preventing harm and rules for reducing risk. Generally speaking, the approach in the professions, especially medicine and law, has been to protect clients and patients against any harm from conflicts, primarily by adopting rules against acquiring adverse interests. However, it is not always possible, or even desirable to seek the elimination of all harm. We brave many risks in order to enjoy gains. Investment, in particular, can never be risk-free and indeed risk in inversely correlated with return. The aim in financial services, therefore, is to manage risk prudently, including the risk that comes from conflicted financial service providers.

3.24 What type of "Conflicts of Interests" do we find in Financial Services?

In the work done by Boatright (2001), he mentioned that conflicts of interest in financial services differ from those in professions in several important aspects: Firstly – with a few exceptions, financial advisers may be one – financial service providers are not professionals in the accepted sense. In short he mentioned "they don't have the commitment to the service of others and of society is paramount". The result is that self-interest plays a large and legitimate role in financial services. A very good example he uses is that of a broker may be an agent and a fiduciary with respect to managing a client's account, but a broker may also deal with that same

client in a buyer-seller relation, as, for example, when recommending certain securities.

By contrast, the norms for the conduct of financial service providers are derived from the contracts that they enter into. In other words, it is the terms of financial contracts rather than the features of a professional role that determine the standards of acceptable behaviour for financial service providers with respect to conflict of interest. In putting it in simple terms, an attorney in a conflict of interest situation is not being a good attorney whereas a conflicted broker, for example, is violating a contractual agreement with a customer.
The distinction between the terms of a contract and the structure of the features of a professional might be regarded as one of degree, especially if professionals are viewed as having a contract with society (Boatright, 2002). There is still a difference worth noting, however, because if this is the case, then it is professionals as a group who make a kind of contract with society, whereas the contract between a financial service provider and a client is between individuals or organisations and is subject to negotiation. Some duties of a broker, for example, are specified by law and are thus like the duties of professionals to the extent that they are inherent in serving a particular role.

Boatright (2002) mentioned further that conflict of interest rules could thus be understood as rules that reduce the agency risk to investors from financial service providers in their roles as agents and fiduciaries. This risk may result either from opportunistic, self-interested behaviour or having one's interests subordinated to those of others. For example, some brokers are offered higher compensation for recommending a firm's own mutual funds rather than the funds of independent mutual fund companies or competing banks (which might better serve a clients needs). Similarly, security analysts for some major banks have bee accused of conflict of interest when the analysts' compensation is tied to their ability to facilitate the underwriting of security offerings by the firm. Because of this conflict, some investors have bought stocks on the recommendation of analysts whose objectivity is compromised. In both of these cases, investors are harmed by conflicts of interest that result in opportunistic or self-interested behaviour by the brokers or analysts on whom they have relied.

A conflict of interest also occurs when a financial service provider is pledged to serve the interest of two or more investors and cannot serve them all equally well. For example, investment banks often serve as advisors to a number of investment funds with similar investment objectives, such as investing in high-tech firms or emerging markets. These banks may also invest their own funds in the same ventures. When limited investment opportunities present themselves, the bank must allot the securities among the various funds they advise and possibly their own funds

3.25 Boatright's lessons in Managing Conflicts of Interest.

Boatright (2002) have made a few suggestions that can be applied in managing conflicts of interest, even in other areas outside the financial services sector:

- Gather data on the extent of conflicts and their seriousness. - No action should be taken until hard data show that conflicts of interest are sufficiently pervasive and serious warrant action. In particular, according to Boatright (2002), that it should not be assumed that conflicts are always wrong and should be avoided as much as possible.
- Involve all the relevant parties. – Only by involving all of the relevant parties can rules be formulated in a process that allows for the representation of all interests, which is essential if there is to be a market for rules. The opportunity for each party to participate in the process of rule making in a market inevitably involves compromise, but the outcome is more likely to be regulation that is acceptable to all parties and is more likely to be observed.
- Be flexible and allow for adaptation by those most closely involved. – Mutual fund companies can best provide oversight of personal investing by fund personnel by being given the flexibility to adopt rules and policies that are tailored to their own circumstances.
- Focus not merely on prohibiting certain conduct but on ensuring compliance. – General principles and code provisions specify the conduct that is prohibited, but the rules and policies adopted should also aim to deter the prohibited conduct and detect non-compliance. The important factors here are reporting requirements that generate adequate data and high-level oversight that effectively utilizes this data.

- Have an appropriate mix of general principles and specific rules. – These rules include a precise specification of who is covered, a list of particular practices that are forbidden or if needed, a clear explanation of exceptions to the rules. No sets of rules are complete and so general principles have a role in any regulatory system.
- Communicate with all affected parties. – An annual signed statement of compliance with all rules and policies achieves this kind of communication.

These applications are very generic and can therefore be applied to basically any model or industry by just adjusting the various variables that one find individually in every different industry.

3.26 The Efficient Integration of the Financial Services Industry.

The financial service industry is becoming more integrated in a number of ways (Berger, 2002). In nations around the world, mergers and acquisitions (M&As) are occurring amongst some of the largest financial service providers. In Japan, the Fuji Bank-Dai-Ichi Kangyo Bank-Industrial Bank of Japan M&A and the Sanwa Bank-Tokai Bank-Asahi Bank M&A are expected to create the world's largest two banks, with about $1,4 trillion and $1,0 trillion in assets respectively. In Europe, the Swiss Bank Corp-UBS M&A and others have also created the largest domestic deposit base in the nation.

There are also considerable integration creating-type institutions that provide many categories of financial services. For example, the Citicorp-Travellers M&A created a financial institution that provides commercial banking, securities underwriting and insurance services. Moreover, considering cross-border integration is taking place in which financial institutions are establishing physical presences in other nations. In Europe, cross-border M&A activity needs domestic M&As in both the securities and insurance sectors. Recent policy changes around the world – particular legislation allowing interstate banking and universal banking in the U.S. and changes allowing easier cross-border entry and common currency in the European Union (EU) – make it likely that the waves of integration will continue (Berger, 2002).

Berger (2002) have identified in his work that efficiency effects of integration covers three complex types of financial integration:

- The national consolidation of financial institutions within a single product category, such as commercial banking, securities or insurance.
- The integration of multiple categories of financial services into universal-type organisations, such as combining commercial banks with investment banks or insurance companies.
- The consolidation of the financial services industry across international borders.

Berger (2002) further constructed a definition for financial services industry integration as inclusive of any event that joins two or more financial services organisations or combines two or more dimensions of the production or distribution of financial services. He identified the following integrations that can be found in Table 1.

Table 1: Simple types of Financial Services Industries Integration.

Simple Type of Integration	Example
Scale Integration	M&As of similar organisations
Scope Integration	M&As among commercial banks, investment banks and insurers
Geographic Integration	Cross-regional M&As of regional providers
International Integration	Cross-border M&As of organisations of national providers
Horizontal Integration of distribution systems	Offer "One-stop-shopping" for multiple services in a single location
Horizontal Integration of production systems	Share information in underwriting loans, securities and insurance
Vertical Integration of production and distribution systems	Shift from independent agents to direct distribution of services.

Source: Berger 2002: *The Integration of the Financial Services Industry: Where are the Efficiencies?*

Scale integration occurs when the production or distribution of financial services is consolidated into fewer, larger organisations, for example, through the M&A of similar financial institutions.
Scope integration occurs when financial institutions expand the range of services produced or distributed. This may take place when institutions move from offering a single category of financial services to becoming universal-type organisations that provide commercial banking, investment banking, insurance and so on, in a single organisation through M&As or other types of expansion.
Geographic integration occurs when financial institutions expand to produce or distribute financial services in an expanded set of locations, such as takes place in cross-regional M&As or when institutions set up subsidiaries or office in other locations.
International integration occurs when institutions expand across borders through M&As, establish new subsidiaries or offices, or use other means. International integration often requires organisations to adapt to difference in language, culture, currency, regulatory/supervisory structures as well as geographic distance.
Financial service providers may also horizontally integrate their production or distribution systems or vertically integrate by combining production with distribution in the same organisation. An important consideration is that any one integration event is usually complex, involving several of the simple types of integration simultaneously.

Berger (2002) analysed the following example; an M&A between two organisations that each previously operated in different nations and provided a different set of financial services. Such an M&A will result in scale integration by creating a larger organisation, scope integration by providing a broader array of services, geographic integration by creating a more geographically dispersed organisation and international integration by creating a multinational organisation. Such an M&A may also involve the different types of simple horizontal and vertical integration of production and distribution systems. Berger (2002) further went further and designed and summarised these complex type of integrations that one might find and combined them into a table that differentiate them into three complex types of integration, their correspondence to the simple types and the research subjects that he has reviewed. The summarised model that Berger designed can be found in table 2.

Table 2: Complex types of Financial Services Industries Integration.

Complex type of Integration	Corresponding Simple Types of Integration	Research subjects Reviewed.
- National integration of financial institutions within a single product category (e.g., M&W of two commercial banks, two security firms, or two insurers).	- Scale Integration. - May also involve geographic integration.	- Cost and Revenue scale efficiency of fin. institutions. - Cost and profit X-efficiency effects of geographic int. - Dynamic effects of the M&A process on cost and profit X-efficiency.
- Integration of different categories of financial services into universal-type organisations (for example, M&As among banks, security firms and/or insurers).	- Scale and scope integration. - May also involve geographic and international integration.	- Cost and revenue scope efficiency effects of universal-type integration. (Much of this is drawn from scope efficiency studies within one category of financial services and from simulations of the risk diversification benefits of universal-type integration).
- International integration of financial institutions (for example, cross-border M&As).	- Scale, geographic and international integration. - May also involve scope integration.	- International comparisons vs. X-efficiency. - X- efficiencies of foreign vs domestic institutions within a single nation.

Source: Berger 2002: *The Integration of the Financial Services Industry: Where are the Efficiencies?*

In looking ahead, it can therefore be seen that economic integration in the financial services industry is expected to continue across all dimensions of Allen Berger's classification system in the years to come. Berger (2002) mentioned further that globalisation of the financial services sector will continue, leading to more giant European firms' acquisition of U.S. insurers and U.S. acquisitions of firms in Europe and other parts of the world.

3.27 Steps to ensure Financial Services follow High Ethical Standards.

Caccese (1997) have found that although having high ethical standards that far exceed the legal requirements, is it very important to have additional steps that need to be followed. He calls it the three-legged stool namely: high barriers to entry, ongoing education about and promotion of the highest ethical standards and an effective and fair enforcement program.

- High barriers to entry – Only persons of high moral character should be able to become professionals within the financial services environment.
- Education – Ongoing education and promotion of the highest ethical standards is accomplished through requiring continuing education in order to maintain membership. Associations actively encourage their governments and regulators to enact laws and regulations that help ensure ethical practices. Some have taken on the role of being governmentally recognized self-regulatory organisations.
- Enforcement – The best code of ethics, the highest barriers to entry and a superb education program cannot prevent ethical breaches unless ethics violations are costly for the perpetrator. Enforcement should be a last resort, but it is an essential element in maintaining ethics in the marketplace (Caccase, 1997).

Caccase (1997) further mentioned that the former U.S. Supreme Court Justice Potter Stewart had the following to say, speaking to a group of lawyers in defining ethics as "knowing the difference between what you have a right to do and what is the right thing to do."

Some people believe that if something is legal, it is ethical. This is on itself in answering this statement, a whole new research on its own and would therefore remain an unqualified and unanswered statement.

Ethics is not simple. You not only have to know the right thing to do but also have the moral fortitude to do it. Being ethical is not always easy, especially in the very wide dimensions of any financial services initiative or division.

3.28 Rationale for a Single Financial Services Regulator in the UK.

Briault (2002) have investigated the rationale for an integrated national financial services regulator in the UK and found that it continues to reflect four primary considerations:

- Market developments such as the increase in the number of financial conglomerates and the blurring of the boundaries between financial products make sector-based regulation increasingly less viable;
- There are economies of scale and scope available to an integrated regulator and there is value in being able to allocate scarce regulatory resources efficiently and effectively;
- There are benefits in setting a single regulator clear and consistent objectives and responsibilities and in resolving any trade-offs among these within a single agency;
- There are advantages in making a single regulator clearly accountable for its performance against its statutory objectives, for the regulatory regime, for its costs of regulation and for regulatory failures.

Financial services firms have also continued to expand through internal growth into new areas. New entrants furthermore continue to widen the range of the financial services they offer to their customers as well.

The UK was not alone in this. The draft legislation to create an integrated financial services regulator in Germany states that: "National regulatory structures need to reflect the realities of the financial service sector, which has become more dynamic and more complex over the past few years. Development on the financial market are associated with increased risk to their stability, which can bets be countered in the future not only through improved collaboration between the regulatory authorities, but through integrated regulation" (Briault: 2002).

In the work done by Briault (2002), he mentioned that the institutional arrangements in the UK provides for a single modern and flexible legislative framework covering almost the entire financial services sector.

He further mentioned that the new legislation provides the framework within which the Financial Services Authority (FSA) operates, including four high-level statutory objectives, the powers available to it, safeguards on the use of these powers and a strong set of accountability mechanisms. An important feature of the new legislation is that, apart from setting out in broad terms the 'threshold conditions' that a firm must meet in order to be granted permission by the FSA to undertake one or more regulated financial activities in the UK, it does not set out any detailed rules and regulations of these firms. These are set by the FSA itself, in its Handbook of Rules and Guidance (Briault: 2002).

When looking at the function of a Financial Regulator, with the focus specifically at the functioning of the FSA, as well as looking at the way it assesses individual firms, one would look at two risks posed by firms. One is the *probability* of an adverse event occurring, while the other is the *impact* that such an event might have.

In considering the *probability* of a problem occurring, particular attention is paid to two types of risk. The first risk is business risk, which includes:

- A firm's strategy;
- Its credit, market and operational risk;
- The nature of a firm's customers and of its products and services.

The second is control risk, including:

- A firm's organisation;
- Its internal systems and controls;
- Its board and senior management;
- Its business and compliance culture;
- A firm's treatment of its customers (its marketing, selling and advice practices). (Briault: 2002).

Impact is assessed in terms of the damage that a problem within a firm could cause to the FSA's statutory objectives. This depends on three main considerations; the first is the degree of systematic significance of the firm (for example, would a problem at the firm have a contagion effect on other firms, or on the industry as a whole?). The

second is the perceived importance of the firm (including the possible impact on market confidence). Lastly, the third is the size and nature of the firm's customer base. The inclusion of these 'impact' factors, based on the FSA's four statutory objectives, means that the FSA does not look at risk in quite the same way as market participants (Briault: 2002).

3.29 The Ethical Dilemma with these transactions in Business.

According to Buchholtz (2003) he used the broad perspective by Otto Bremer on how to capture the core of what ethics is all about. These questions are all very generic and can thus be applied to any kind of dilemma that one might come across in every day life. These questions can thus also be applied when looking at this possible dilemma that might be unfolding. The four different questions are as follows:

- What is?
- What ought to be?
- How do we get from what is to what ought to be?
- What is our motivation on all this?

In looking at the first question, it forces us to face the reality of what is actually going on in an ethical sense in business or in a specific decision or practice. Its purpose is to help us understand the reality of the ethical behaviour we find us in the business environment.

The analysing the second question, it is certainly not a scientific question. This question seldom gets answered directly. An example might be, "How should we treat long-time employees when the company is downsizing or moving to a foreign country?"

The third question represents the challenge of bridging the gap between where we are and where we ought to be with respect to ethical practices. This represents an action dimension. These "ought to be" questions become goals or objectives for ethical practices. They become the moral benchmarks that help us to measure progress (Buchholtz: 2003).

The fourth question addresses the motivation for being ethical, because sometimes it reveals some manipulative or self-centred motive. The perfect example here would be to ask someone who makes a R1, 000 donation whether the reasons behind it all

is because they believe in the cause or just because they are getting maybe a tax relief because of it.

One of the earliest circumstances in which government felt a need to regulate occurred when a natural monopoly existed. Buchholtz (2003) is of the opinion that a natural monopoly exists in a market where the economies of scale are so great that the largest firm has the lowest costs and thus is able to drive out its competitors. Such a firm can supply the entire market more efficiently and cheaply that smaller firms.

Monopolies such as this may seem "natural," but when left to their own devices could restrict output and raises prices. This natural abuse that may happen in any business practice, justifies the regulation of such possible monopolies. This paper would therefore try and look on a very high level whether this may be the case with this possible transaction in the financial services industry. In order to be able to 100% prove or disapprove it, an in depth investigation would be needed, that will fall outside the focus of this specific paper. This paper would therefore only touch at some of the possibilities.

Chapter 4: Research methodology

The target population, as well as main stakeholders of this research are specifically aimed at people in management positions involved in the Share Transfer Industry at the moment. The population consist mostly about the 2 transfer secretaries, 6 CSDP's, STRATE, as well as the JSE. Further Stakeholders that forms part of this industry would be the brokers on the Stock Exchange as well as the listed companies on the exchange, or in other words, the issuers. The idea of this sample is that by selecting some of the elements in a population, we may be able to draw conclusions about the entire population. This population element is the subject on which the measurement is being taken. It is the unit of study (Cooper & Schindler, 2003: 179). The reason why it was decided on the sample design is because of how well it represents the characteristics of the population it represents.

A formal study would be conducted where the variety of objectives would be served (Cooper & Schindler, 2003: 161). The main objective here would be the descriptions of the phenomena or characteristics associated with a subject population (the who, what, when, where and how of a topic).

From this population in total, simple random sampling will be taken, with whom interviews via questionnaires will be conducted.

Another reason for the focus on management only would be to analyse information from a higher level of expertise in the industry. The information that this research wants to gather would be system specific as well as involving a specific environment as well as a specific subject and/or specific topic.

- Because only personal interviews would be conducted in this qualitative research, was a decision made to make use of a maximum of only 10 properly structured questions that are system as well as topic specific. The downfall in making use of a higher amount of questions would be that because the type or target market, it would be difficult to conduct a fair amount of interviews that would be complete enough, because of a high amount of time constraint on their side.

Data analysis usually involves reducing accumulated data to a manageable size, developing summaries, looking for patterns and applying statistical techniques. Scaled responses on questionnaire and experimental instruments often require the analyst to derive various functions, as well as to explore relationships among variables. Further, researchers must interpret these findings in light of the research question or determine if the results are consistent with their hypotheses and theories (Cooper & Schindler, 2003: 88).

Another main focus in the construction of the questionnaire would be aimed not to try and discredit any of the relevant parties and/or any of the regulatory institutions. What might come out in the research would be the fact that the Share Industry in South Africa might not have the need for such a huge amount of role-players (different stakeholders) in the Share Industry.

Recommendations might surface that there is a need to minimize some of the stakeholders involved. This is actually only an assumption at this stage and there is no proof at this stage that this actually might be the case.

Very specific care has to be taken here not to offend any party or to initiate any legal action from any of the parties involved.

A considerable amount of data would also be collected beforehand by personal interviews that will be conducted by the researcher. This would obviously minimize the need for obtaining a legal opinion, because these interviews would be conducted with the key role players in the industry, i.e. Monica Singer, CEO of STRATE, Russell

Loubser, CEO of the JSE, Stan Lorge, CEO of Computershare, the only non-bank CSDP in SA, to name a few.

These data collected with the personal non-structured interviews, would be used as background information that lead to the forming of the problem statement as well as all the relevant sub-problems. This is very important to be able to visualize the current situation as it is, from the researcher's point of view, as well as from all the stakeholders' point of view and the specific situation they all are at this stage.

It will be expected from all the participants to have at least a reasonable knowledge of the electronic share transfer industry and to have a good knowledge of most of the specific financial instruments available to the Securities Trading environment in South Africa.

- Prove or disapprove that STRATE can perform a function of being both regulator as well as service provider, given the objective to reduce settlement costs, provides a real time online register to issuer clients and maintain a level of competitiveness in the market that ensures that monopoly does not result.
- Vested interests for stakeholders and key players need to be protected in this all-incubating solution being offered by STRATE: so this research also investigates if these requirements are in place or not.

The first outcome of the attempt to set up all the relevant interviews experienced some setbacks due to a Competition Commission decision or ruling regarding the outcome of the attempted deal. It wasn't really expected that the Competition Commission would intervene and made a ruling so soon regarding this proposed transaction.

When the researcher started conducting his research on this topic at the beginning of the year, there were no clear indication that a deal or a proposed transaction like this one actually would happen. It was then decided to research the possibilities, if any, that a situation like this might happen in South Africa, as explained in Chapter 3, that have happened elsewhere in the world.

When the specific deal was firstly publicised in June, it was not anticipated that any closure or any final outcome be expected soon. An application was therefore subsequently made to the Competition Commission, during the latter part of June 2005, to raise objections against the proposed merger or acquisition by STRATE of the company Ultra registrars.

Due to the sensitivity of the proposed transaction, as well as due to the possible pending on a ruling by the Competition Commission, was it difficult for the researcher in setting up key interviews with the subsequent heads of all the stakeholders involved in the Securities market due to the specific timing of what was expected by the Competition Commission to either uphold the proposed transaction, or approve the deal in full. A considerable amount of respondent that was targeted therefore declined in giving any comment regarding the transaction, as well as any topic surrounding any information that might have been made public by the pending decision of the Competition Commission.

STRATE as well as Ultra Registrars were firstly consulted but declined in giving any comment on the proposed transaction or disclose any information relating to the deal. An attempt was also made after the decision was made public by the Competition Commission at the end of October, but they also declined. Both of the parties were also reluctant in giving any comment to the financial press even after the deal was upheld by the Competition Commission.

During the second phase of interviews, the focus was placed on all the CSDP's that are present in the South African Securities market. Interviews were subsequently granted by the heads of the CSDP's at Computershare South Africa, Standard Bank of South Africa as well as Nedcor Bank Limited. The CSDP's at ABSA Bank Limited, First National Bank Limited, as well as the CSDP at Societe Generale declined in giving any interview or any information regarding the proposed transaction as well as on the outcome of the ruling. The CSDP's that have declined felt that due to their shareholding within STRATE as well as the possibility that STRATE might appeal the transaction, were given as reasons why they would not be prepared to give any comment at this stage.

The third level of interviews were conducted and focussed in the issuers in the market as well as on the brokers within the Securities market. Due to the indirect involvement by the issuers in the market as well is with the brokers within this specific market, was it decided to only conduct interviews with a maximum of two listed

companies, with a rather shareholder base as well as with at least one rather large broker within the Securities market.

Interviews were therefore granted by the Company Secretaries of the companies Altron as well as the company Metoz Holdings, previously known as Metro Cash & Carry. On the brokers side was an interview granted by Cadiz, which is a rather large broker on the Securities Exchange.

After the finalisation of all three levels of interviews, as well as after the second attempt in getting more stakeholders involved, were all the transcripts summarized and compared with each other in order to find and see whether there might be a common trend or different opinions regarding the proposed transaction as well as whether it would be healthy for any regulator to be able to become a service provider within the same market.

The major limitation within this study was with the refusal by STRATE and Ultra Registrars, in granting interviews as well as by waving the opportunity in getting their own objective view behind the proposed transaction. The outcome of this qualitative research would therefore only focus on the opinion of all the relative minority parties involved directly as well as indirectly by this transaction. Their own objective of how they see the market as well as to how they expect the market to handle these kinds of transactions would therefore be investigated.
The proposed open questions were skimmed down to only eight and were conducted in numerical order via a Dictaphone.

Chapter 5: Research results

5.1 Profile of interviewees.

The first personal interview was conducted with Mr Tertius Vermeulen, Head of Custody at Computershare Limited, the only non-bank CSDP in the securities market. It surfaced that he played a very key role during the submission of the objection to the proposed deal by STRATE to the Competition Commission.

The second interview was conducted with Ms Pam Gishen, Company Secretary of the Company Metoz Limited, previously known as Metro Cash & Carry. She came very strong to the forefront as a person who strongly disagreed with the whole idea of being a regulator and playing the market, not only in this specific sector, but also in all other sectors across the whole world.
The third interview was with Ms Karin Griffin, Director of Custody at Standard Bank's CSDP. As a shareholder in STRATE, it was found that it is of very importance to her the whole structure of the deal as well as whether there would be a possibility to STRATE to appeal the decision by the Competition Commission and whether they would finally decide to appeal as that whatever is decided, would have a direct effect on them based on their shareholding in STRATE as well as their possible change in role within the market.
The fourth interview was conducted with Mr Andrew Johnston, Company Secretary of the highly acclaimed listed company Altron. As board member of the Advisory Board, he felt strongly for the role of Corporate Governance in any proposed transaction, as well that he is a huge supporter of hard competition within every market sector, but strongly apposed to any kind on monopoly that might have a negative affect on service delivery within the Securities Services market.
The fifth interview was conducted with Ms Erica Bruce, registered broker of the firm Cadiz. She came through as a very well spoken lady with quite different scenario analyses' than all of the other interviewees. She strongly apposed to any stakeholder within any sector or market in any economy, who's having the opportunity to increase their power base without proper set out boundaries. She strongly felt that a strong economy needs strong competition with the same subsequent strong compliance as well as good and strong corporate governance.
The sixth and last interview was conducted with Mr Richard Samson, part of Operations at Nedcor Bank Limited CSDP. He was with the opinion that it will always be good for any market in having strong and healthy competition in place. It remains very risky if someone gains too much power within any kind of sector or market.

5.2 The analysis of the questions.

Relating to the answers to question one, all but just one interviewee felt that they had the same opinion as the interviewer that STRATE and the JSE both determine the

shape of the securities market. An interesting answer surfaced from Ms Griffin that she felt that every stakeholder within the securities market have enough opportunity to raise their opinion regarding any proposed changes within the market and that through consultation each and every one get the opportunity to raise their concern in order to be able to get proper buy-in from all the relevant stakeholders. These were not found at all with any of the other interviewees. They all felt very strongly that they don't have any control or any substantial input in or before any decisions are made that might have a direct effect on the whole market. They all felt that power as well as the amount of power might play a huge role in how any market will function within any market and that it easily can be misused by any directly involved party.

In relation to the second question different opinions were raised on how big role corporate governance should play within the statement regulation and participation needed to be separated. More than half of the interviewees felt that it is impermissible and that it is a key factor within good corporate governance to have proper separation within any regulation arm as well as to any participation within the same specific market. It was further mentioned that this would imply to each and every sector and not only to within the securities market alone.
One interviewee had a serious concern regarding cost as to the fact that in having all these regulations as well as different compliance models, might have a direct implication in the fact that control might be lost in complying to all the rules as well as submitting compliance report to whoever might need them. In theory it sometimes might look correct to have proper separation, but to what cost? The other side and downside to this comment is that at the end of the day you don't want to sit with a monopoly within your own market.
Across board every interviewee were asking for transparency as well as to that security services be provided free and fair, efficient as well as cost effective to every sector within the share securities market

Question number three also had a different perspective of how the stakeholders see this transaction as well as to how they experience this within the specific securities services environment. All but one of the interviewees supported the deal in theory, depending on the final outcome of the Competition Commission's decision. Ms Griffin was of the opinion that she has to support the deal as a shareholder of STRATE, but

she could not elaborate on it any further due to the sensitivity of the matter as it was standing at that stage. The true financially as well as strategically benefits if any regarding this deal could not be properly tested, due to the fact that the main role-players within the construction of the transaction declined to give any comment. An outsider's opinion could therefore only be given by direct and indirect role-players within the share securities market.
A comment was made by Ms Bruce that the outside world might look at this differently as well as in a more positive way, with the proposed aim to create a safer and more controlled investment market for any possible future foreign direct investment (FDI), that might come to the South African market due to the announcement of the initial deal. Some people might though interpreted it in a different way. This comment was actually not further tested within the purposes of this paper.

The results to question four were all the same with just a small variation on the answers submitted by Mr Vermeulen. It was very clear that all the interviewees were within the same opinion that all the information pertaining to shareholders do belongs to the listed companies or as previously mentioned the issuers. Mr Vermeulen was of the opinion that the CSDP can be seen as a co-owner in some way of the information, but only within full consent of the issuer. All the issuers agreed that this right is fully protected by the Companies Act in theory. This question would have been able to be tested more thoroughly with the co-operation of STRATE and Ultra Registrars, but could obviously not be disclosed by them. All the interviewers felt very strongly that neither STRATE nor a CSD would have the right to own this information as well as the right to disclose any of the information without proper consent. These comments haven't actually been tested within the law and no further comment can thus be given based on facts.

The results to question number five had more or less the same result, with the main aim and focus that in order to be able to be sustainable, each stakeholders needs to rethink their position, as their roles might change in some drastic way towards the future of the market. All the interviewees agreed that each market participants still have a major role to play within the industry. There were total agreement that some of the roles might have changed as well as with the possibility that some of them

might have to swap roles in the future. The researcher was of the opinion that there would be some sort of consolidation of functions as he thought there were too many stakeholders involved in such a small market with a very low market capitalisation such as within the South African share transfer industry, but according to the above this seems as not a possibility at the moment.

The information pertaining to the comment raised in question number six also had more or less the same response given through by all the interviewees. Even though that we are very far advanced in infrastructure within the emerging markets, it was found that this can be seen as the main reason why people are still having their shares in certificated form and not having it dematerialised in electronic form. All the interviewees felt very strongly that this matter needed not to be referred to the Constitutional Court as it might uphold each and every individual right to freedom of choice. They felt very strongly that this have got no constitutionality's about it and that the Court mustn't rule or attempt to make a ruling on it at any point in time.
All of the interviewees agreed that there might be a problem regarding fraud, but that it weighted lightly against the backdrop of the comment "freedom of choice". They felt that if there is no incentive to change to electronic, then why do so? It was also found that every one agreed with the ruling that no person would be able to buy or sell shares if it was not dematerialised into electronic form. They finally all agreed that no enforcement would be needed at any point in time.

Some very interesting comments were raised during the conducting of the interviews regarding the comment about who would maintain information pertaining to shareholders if transfer registrars might not be required further. The bulk of the comments were formed surrounding the comment that definite roles within this industry will need to change to be able to accommodate al the relevant stakeholders for the future. With the new rules and regulations that are around, would it be very difficult to maintain these kind of information as well as detail relating to information without someone like transfer secretaries, who is equipped to render the service as well as having the right amount of resources already in place to accommodate the request.
The vast amount of interviewees felt that this would always be a service or function that would be outsourced, as no company, in particular the biggest listed companies,

would have the resources as well as knowledge to be able to conduct this service by themselves. They strongly feel that from a company perspective that it would rather be better for the company to rather keep their focus on their core business and to keep on outsourcing these kinds of services instead of keeping them in-house.
All the interviewees felt that if transfer secretaries eventually would fall away, someone else would stood out and take over that function as it can be seen that neither of the interviewed stakeholders do see them fit to be able to take over that function as well. An opportunity might thus arrive for any company to come to the forefront in possibly taking over that function if that would happen one day.

In conjunction to what was said during all the interviews relating to question number eight, one main theme was picked up and that of that there needed to be clear separation of activities and that no-one can be allowed to do both without formal as well as informal segregation of duties. All the interviewees had the concern that it can not be allowed for STRATE to compete within the market and they are collating all the data themselves. It was thus felt that this definitely might lead to conflict as well as unfair business practice within this industry.
Another issue that was raised by Ms Bruce is the question of cost? She had a concern that what would happen if STRATE decides to increase their fees with example 100%? She mentioned that this could directly correlate with the comment that she have raised at an earlier stage about having too much power in the same industry. In short to summarise this question it seems like everything boils down in the threat of STRATE having too much power and with the possibility of an unfair advantage or disadvantage to certain stakeholders within the securities market.

Chapter 6: Discussion, conclusions and recommendations

6.1 The element of surprise.

What seemed at first to be groundbreaking, as this has never happened before in South Africa, nearly happened? As mentioned earlier in the paper, was the main reason for possibly conducting this research basically based on reading of what has happened elsewhere in the world as well as looking at the possibilities of something familiar happening in South Africa? There was never any doubt that something

similar might happen, but the timing for it couldn't have come at a worse time, depending on what side you are looking at.
In constructing such a deal or looking at the possibilities of constructing such a deal a lot of factors need to be look at as well as the analysis of a few scenarios. As mentioned earlier in Chapter 3, Quintyn & Taylor mentioned in their research that financial sector supervision, in particular, is more rigorous and intensive that supervision in any other regulated sector. Just for that fact, the paper was drawn up to try and test it within the Securities market as such. Their research highlighted the fact that there is always a strong call for a regulator in any sector to be totally independent. This ruling or decision by the Competition Commission in the upholding of the proposed deal thus placed a damper at the time on the possibility of further investigating the possibilities even further as well as into more detail.

This proposed deal set out by STRATE can be seen as a direct outflow of what have happened with the attempt by Computershare as discussed in Chapter 2. Computershare tried at the time to see whether they could provide a real-time service, very similar to the product that STRATE aimed in providing it to the market with the proposed deal. Not enough information was found during the research in order to justify, but it seems as if it might be worth it in investigating this further during any possible further study on this issue.
This attempt by STRATE in order to do just this can clearly be seen with the specific media release that was publicised during the interview with the current CEO of STRATE on Moneyweb, the 6th of June. The purpose that was given for the transaction have the exact same end result that they would be aiming as the result that Computershare was aiming at during May 2004. The question here might be to find the real reason why STRATE at that point in time didn't want to give their co-operation for the deal at the time. When looking at all the options, it would be very easy to make the assumption as to why they opposed the deal and refused co-operation at that time? Did they know anything that has subsequently surfaced before the Competition Commission's ruling? For the time being will this question remains unanswered.

6.2 The argument for independence.

A few amount of arguments surfaced during the conducting of the interviews as well as during the general discussions that took place during the past year regarding whether STRATE can be seen as the regulator or not. As can be seen with the information gathered, the overwhelming evidence appears to be that STRATE can definitely be regarded as the regulator within the securities market. In adding to that, did Quintyn & Taylor found that in passing the laws that create regulatory agencies, politicians properly set and define regulatory and supervisory goals. They mentioned in adding further that once those laws are in force, regulators must be free to determine how to achieve these goals as well as the fact that they should be held accountable if they fail to achieve them.
It seems clear that STRATE definitely falls within the lines of Regulatory Independence as mentioned within the model by Quintyn & Taylor that was designed by them pure to discuss the dimensions within a model of independence.

It is therefore very clear through the above mentioned press releases that STRATE envisages supplying transfer secretaries, being now only Computershare, with a download of data on a monthly basis and through Ultra Registrars offers a real-time service identically to the initial product that Computershare have proposed through to STRATE, of which they initially refused to assist Computershare with. This was clearly highlighted in the gathering of information through the conducting of the interviews that the interviewees felt that with the allowing of the deal to go through, there would always be a certain element of worry whether the above happenings might eliminate competition and that there might have been increasing fears that this will lead to a monopoly run by STRATE, which in turn might also have far reaching effects that are not discussed further in this paper.

6.3 Would it be possible for STRATE to abuse or dominate?

It became very much clear, when looking at the evidence that was conducted that there are fear in the South African market that it might happen. The actual extent as of to at the exact level of fear was not properly looked at and would fall outside the borders of this specific research paper.

In looking at the above, would it therefore be possible to assume that each and everyone of the stakeholders interviewed had the opinion that they are afraid of the unknown, that they are afraid and not sure what STRATE's main aim might be with the market. They all see and feel that there might be a real fear for any party to dominate, given the fact that they are given the opportunity to gain too much power.

When looking at the South African Competition Law, as discussed in Chapter 3, that any firm that has market power, is considered dominant, regardless of its market share. When looking at the discussions it was found that Ultra Registrars had a market share in the region of 15%. STRATE's dominance would therefore not be seen at that specific point in time based on a threat due to the fact of their dominance in the market based on their market share, but due to the fact that they would be able to have and unfair advantage regarding the access of information that might thereafter create a ripple effect within the market as such. This might lead to an increase in market share with the strong possibility of taking over the market, as can clearly be seen based on the reactions conducted during the interviews.
Most of the stakeholders are afraid that the following might happened as discussed and described by the Competition Commission, whereby the abuse of dominance can be seen as refusing a competitor access to an essential facility (provided that it is economically feasible to grant access).

6.4 Why the support for the Commission's ruling?

It became very clear while conducting the interviews that all but one supported the ruling made by the Competition Commission. This was discussed in the previous Chapter, but it remains an interesting scenario as to find out the real reason why there was so much support against the proposed transaction. It was therefore concluded that one of the main reasons were that it might create unfair business practice within the market, as well as the possible unfair advantage Ultra might have over the rest of the stakeholders. All the interviewees agreed that the industry needs firm competition in order to provide a service of superior quality and properly defined within certain pre-determined sectors. No one would have lifted an eyebrow if another financial services company was the proposed buyer and no-one would have objected to that proposed transaction.

Another reason why there was so much support in submitting an objection to the proposed transaction was discussed by Kruse in Chapter 2 while in preparation for his submission to the Competition Commission that this proposed acquisition had from a business perspective very interesting scenarios. STRATE, in fulfilling their regulatory function, is the only entity that has access to all the information, at any given time, pertaining to dematerialised shareholding. It is thus the only entity that can provide a real time registry to the issuers in respect of dematerialised shareholding. They lack, however, the ability to provide information relating to the certificated environment as Ultra Registrars and Computershare control this environment as the only major transfer secretaries in the market. Ultra Registrars and Computershare, having lost their traditional markets through the statutory dematerialisation process, have focussed on providing issuing companies with share registry services, as defined herein above, in order to substitute the loss of income resulting from the loss of their traditional markets. However, it was very clear as from the beginning that Ultra Registrars and Computershare were always extremely vulnerable, as they always feared that STRATE would utilise the information gained from the exercise of their regulatory function to compete against them in the market for registry services. Well aware of their vulnerability to the possible misuse of STRATE with the information gained through the exercise of their regulatory function, have subsequently forced Computershare to consistently attempt to improve its service to their relevant issuing companies.

The above scenario had alerted serious and very important concerns amongst all the relevant stakeholders as to what their next step would be if the ruling was in favour of the transaction.

What concerned the researcher during the drafting of the interviews were certain of the comments that were raised, such as that some of the listed companies would have objected and protested against the proposed deal and that it might have resulted in some real bad publicity of which the South African economy can't afford at all at this stage.

6.5. What thought process went into this deal?

This would have been a very interesting discussion in getting behind the whole reason for this proposed transaction and what strategic decisions were made by

STRATE in order to make the final decision to make an offer for the business. Unfortunately, would this be answered based on speculation as well as through analysis' made in looking at similar proposals that took place worldwide, because of the failure in getting any response from STRATE and Ultra Registrars on the above topic.
A broad discussion took place in Chapter 3 whereby a closer look was taken as to what happened in Australia as well as a look at any possibilities of finding any similarities as to what have happened in the US and the UK.

The most interesting factor that was found in Australia was the fact that the ASX was a listed company on the exchange with its own disclosure obligations and its obligations as a market supervisor. At that specific point in time there was no legislative basis for regulating conflicts between ASX's commercial interests and its obligations as market supervisor.
It was therefore found that after the ASX's listing it became clear that Australia had indeed embarked on an adventurous journey as the ASX urged forward with a number of commercial initiatives that gave rise to regulatory challenges.
As mentioned further in Chapter 3, were there two exchanges in Australia, the ASX and the SFE. The correlation that can be drawn up between the South African scenario and the Australian one is that both the ASX as well as Computershare of Australia announced takeover bids for the SFE. The direct correlation can thus be made in comparing the proposed deals in both countries. Incidentally, neither ASX nor Computershare succeeded in their bids and SFE remains independent today.

The South African market can learn a lesson here from what have happened in Australia that Lucy have mentioned in Chapter 3 that It is therefore very clear from the Australian story, that in an environment of market demutualisation, regulators need to be prepared to quickly respond to conflict and other issues that might arise from the demutualised entity pursuing its own commercial objectives. These issues would not always be obvious in advance and may arise very quickly without prior warning from any of the parties, simply through the pursuit of legitimate commercial opportunities.

6.6. The final conclusion and recommendation

In summarising it becomes clear, given the fact the information that were collated, that the proposed transaction never seemed to be on track for success from the beginning. It is not clear whether the related parties were ill-informed by the response of the market or whether they underestimated the attempt during the submission to the Competition Commission of the opposing parties. It would therefore be unfair in making such a comment as neither STRATE nor Ultra Registrars, made use of the opportunity in giving their reasons and comments regarding the proposed transaction.

In analysing the situation from the one side, it seems quite clear that a chance was taken and it didn't succeed. The option thus remains there for STRATE to oppose the ruling and formally lodge an appeal. At the time of finalisation of this paper, STRATE or Ultra Registrars have not yet made it public of what their next step in this would be. A clear indication on what their next step would be is expected by the market before the end of the year as the appeal, if decided by them in doing so, would only be heard at the end of the first quarter of 2006, that in itself might be a bit damaging in order to still salvage the deal form going under in total.

A very clear indication was given by the majority of the interviewees that they firmly opposed the deal from the beginning stage that specific day it was made public. Arguments were formed surrounded by corporate governance, creating a monopoly, as well as having direct conflict of interest. Direct correlations were made as to what happened elsewhere in the world and to whether any direct comparisons could be made. No one opposed the deal that of the proposed buy-out of Ultra Registrars – they were just against the fact that the proposed buyer was STRATE and not just any other competitor within the securities market. Each one of the arguments were tested with all the respondents and became very clear that some of their arguments did actually bared fruit, for the same reasons as the reason as to why the Competition Commission upheld the proposed acquisition.

All the stakeholders involved in this market felt very strongly that competition in any market can only be to the benefit of the market, as strong competition creates a ripple effect that have a direct effect on the increase of service levels as well as increased

service level agreements (SLA), as well as to achievement of keeping up to the agreement. All the relevant parties have had a serious problem with having too much power and authority within a specific market. As explained earlier that even the Competition Commission had a problem with dominance within the same market as it may create an non-free and fair environment to do business ruled by a monopoly with the possible aim to be in it for own gain alone.

This paper has the potential to be explored even further as well as having the possibility of being broken down in a few more direct research topics that focus on a specific arm within this industry. The difficulty of this specific research was clearly shown in the gathering of the research results due to the fact of the timing of the project ending within the same month as the ruling by the Competition Commission. The results would have been analysed from a broader perspective with the participation of STRATE and Ultra Registrars during the interview processes. At the end of the day was it possible to summarise the view the market had on this transaction as well as the markets opinion on certain key factors that have surfaced on a few occasions in the broader financial services market: i.e. Corporate Governance within the financial sector, accountability and the taking of responsibilities for your own actions, threats of being monopolised, possible monopoly creation as well as the strategic acquisition within the same market.

Further research can be undertaken that can help us understand the concept of whether all regulators needed to be independent as well as to "who needs to regulate who?"
The difficulty in this research, apart form the refusal to partake, was further due to the fact that no transaction like this proposed one have taken place within the financial services market, which made it difficult in collating all the relevant information.

Strong competition is needed within the financial services sector, but by narrowing it down, mainly the securities environment. Service levels are going out of the window and each and every participant have the main aim of making his money and climb out as quickly as possible. There seems to be reluctance towards sustainability and that can only be addressed with good business practice as well as incentives from the Government if possible.

Good Corporate Governance as well as strong ethical business practice must form the cornerstone in any proposed transaction or merger within a sector. There is always the possibility that any hidden agendas that might have been the main aim in acquiring any division or company, have the tendency to rebound or return to the company as with a boomerang.

Pending the outcome of what STRATE's decision might be regarding the future, the possibility would remain that any other institution or company attempt to proposed a same kind of structured deal, just as long as they are no regulator of some sort wanting to play in the same market.

Chapter 7: Article for publication

Abstract on Article.

This paper will look and analyse at what have happened with the proposed transaction whereby STRATE, who currently is the regulator within the securities market, publicised an offer to acquire the transfer secretary Ultra Registrars, which is currently a service provider within the same securities market. This paper would further focus on the opinion on all the stakeholders involved within the market, by means of finding out their feelings about the deal on whether how much good of bad this may bring to the securities market. An investigation will also be done on what have happened elsewhere in the developing countries in the world by trying to find out what the outcome was with familiar transactions and how it was dealt with. This paper would also look at this deal from a Corporate Governance perspective and try and find whether there might be any issues. The possible conflict that might surface will also be looked at as well as what the opinion might be from the perspective of the Competition Commission

Is it healthy as well as free and fair for a regulator in the financial services environment, to become a service provider as well in the same industry to where he subsequently act as one of the regulators? This whole question, as well as the debate surrounding it all started with the purposed acquisition of Ultra Registrars by Share Transfers Totally Electronic (STRATE), during the month of June 2005.

STRATE Limited is controlled by the JSE with a shareholding of 41% and the rest of the shareholding is owned by the four major banks. Ultra Registrars (Pty) Limited, is a company that provides registrar services to companies listed on the Johannesburg Security Exchange of South Africa (JSE). In other words, Ultra Registrars act as transfer secretaries for those listed companies, by providing them with all their shareholder information and oversees their dividend payments. STRATE as the Central Securities Depository is subject to the supervisory functions of the Financial Services Board (FSB), as well as the Registrar of Securities Services. Further within the securities services environment, the following markets can be identified:

- The market for the holding of a centralised securities depository, whereas STRATE has the monopoly as a result of the Securities Services Act No. 36 of 2004, (Republic of South Africa, Financial Services Board, 2004).
- The market for custodial and settlement services relating to securities. In this market there are currently six CSDP's, but the market is overwhelming controlled by the four major banks, as they are the primary CSDP's. Of these six, only one, namely Computershare, participates also as a transfer secretary.
- The third and final market is the market for the provision of share registry services (Kruse, 2005).

The primary purpose or objective with this paper can therefore be seen as to research as well as investigate the question if STRATE can be seen as both regulator as well as a service provider to all the issuers in the share industry. Is this possible? Would this be allowed to happen within any industry? This paper would obviously therefore discussed this in detail been researched in detail with this paper.

A various amount of problems do arrive with this transaction, mainly by how will the market with conjunction to al the various stakeholders react to it as well as to what possible ethical issues are involved here. Because conflicts of interest are present in almost all aspects of life, we need to be more precise about those of concern here. Mishkin gives the following description for conflict of interest in financial markets:
"Conflicts of interest arise when a financial service provider, or an agent within such a service provider, has multiple interests that create incentives to act in such a way as to misuse or conceal information needed for the effective functioning of financial markets", (Mishkin, 2003: 222). Mishkin further mentioned about possible conflicts and the handling of conflicts

of interest that the analysis of conflicts of interest begins normally with the observation that they present their main problem for the financial system when they lead to a decrease in information flows that make it more difficult for the system to solve adverse-selection and moral-hazard problems that can slow the flow of credit or information to parties with productive investment opportunities (Mishkin, 2003). Research used by Mishkin (2003) showed with evidence surveyed by Crockett et al (2003), suggests that these incentives do work to constrain conflicts of interest in the long run, but the extent to which they are effective in the short run depends on factors such as transparency and incentive structures within firms.

Another possibility that have surfaced recently was the fact that there might be fears in the market that STRATE's move with acquisition of Ultra can be seen as a move to a Consolidated Share Register (CSR), with a possible aim to eliminate competition and eliminate all key players of the industry, starting with all the brokers, with an overall fear of becoming a monopoly.
An important factor that was found during the collating of information was the fact that in a recent survey done for Computershare by the company Sales Outsourcing, it was clearly found that there is a definite need to provide listed Companies with a real-time online register, with direct access to it (Scott, 2004). At this moment all the listed Companies receive a register that can be sometimes as much as a month old. This becomes particularly important to issuers when conducting take-overs, for them to be able to communicate with their shareholders on a real-time register, as opposed to a register that could be outdated by one month.

The main purpose of this paper would therefore be to try and see the effect this transaction may have on the whole share transfer industry, with the main focus on free and fair business practice with proper controls and regulatory aspects in place. A correlation would therefore be made to try and see how other Security Exchanges around the world adapted themselves to transactions like this, with a look at how regulatory issues are being addressed in their different environments.
The issue whether there might be a conflict of interest would also being looked at in conjunction on how the market sees this transaction as a whole. A detailed discussion would be made on what kind of qualitative research method will be used as well as the specific results achieved with the research. The final discussion on the research would be based on the

findings of the results in conjunction with the correlations that could be made with the literature reviews.

During the mid of 2004, Computershare had an indication on what the market wanted and it was proof was found by the research that was mentioned earlier in this paper. Computershare at that stage, recognizing the competitive advantage of providing a real-time service, created a product that will provide such a service. However, in order to give effect to the product, it required the co-operation of STRATE in order for them to supply the relevant information that Computershare would be needed, in time. However, in order to give effect to the product, Computershare required the co-operation of STRATE, with the regular deliverance of information more that once a month. STRATE advised Computershare as follows thereafter: "The STRATE management team have reconsidered your proposal and we confirm that for a number of strategic- and practical reasons, we do not believe that it could be appropriate for us to become directly involved in this initiative at this particular time" (Kruse, 2005:12). Exactly a little bit more that a year after STRATE said that they don't want to get involved in something like the announcement of their proposed deal was published in where the clear purpose of the transaction is to be able to provide issuing companies with a real-time register, thereby monopolising for STRATE the market for registry services. It is therefore very clear through the above mentioned press releases that STRATE envisages supplying transfer secretaries, being now only Computershare, with a download of data on a monthly basis and through Ultra Registrars offers a real-time service identically to the initial product that Computershare have proposed through to STRATE, of which they initially refused to assist Computershare with. This paper would therefore investigate further whether the above happenings might eliminate competition and become a monopoly an all the markets in a very short space in time.

This paper went further in focussing on certain problem areas that were investigated of which a considerable amount of conclusions could be drawn at. One of the first arguments that came to light and that were formally investigated, levelled down to the fact that whether if Financial Sector Regulators be independent or not? It was found during the research that increasingly, both policymakers and policy analysts are recognizing the need to shield financial sector regulators from political pressure to improve the quality of regulation and supervision with the ultimate goal of preventing financial crises. It is surprising though that few analyses have systematically discussed why independence for the financial regulatory agency might be

desirable and how it might best be achieved. When looking at regulators and supervisors in nations around the world, it was found that they are charged with managing the health and preserving the stability of the financial system (Quintyn & Taylor, 2003).

Quintyn & Taylor further based their research on what certain rationale could be found for regulation within that sector. They clearly found that during many of these recent financial crises world wide, policymakers in the countries affected have sought to intervene in the work of regulators, often with disastrous results. It is therefore now increasingly recognized that political meddling has consistently caused or worsened financial instability. This strongly brought to the fact and highlighted it very strongly here that the call for a regulator in any sector should be totally independent. It can therefore be aimed that the two main regulators, namely STRATE and the FSB, within the share transfer industry, or in other words, the securities environment to be totally independent and to rigorously keep their focus on monitoring and regulating this industry as a whole. Having a proper system of "checks and balances" in place is extremely important according to Quintyn & Taylor (2004). It is mentioned that national political culture can also determine whether a country is able to achieve regulatory and supervisory independence. In many Western countries, long-standing political institutions such as a transparent political process, a system of constitutional "checks and balances" and a free press support regulatory independence. But many other economies around the world still lack some of the institutions that would provide a secure basis for regulatory independence. The parallel with financial regulatory agencies is straightforward, although it cannot yet be tested extensively because few independent agencies do exists. However, studies so far done by Quintyn & Taylor (2004) show that "checks and balances" tend to insulate financial sector supervisors and to encourage better and more prudent regulation.

Another possible problem area that was investigated looked at the element of Competition Law within South Africa and whether this might have been affected with the proposed deal that was announced. A very important factor that came to light was the fact that the maintaining of consistent competition policy in regulated sectors will require reinforcing the relationships with sectored regulators (Burgeat, 2003). Unlike most competition statutes, which typically group all restrictive practices into a single rule, South Africa's Competition Act separates the rule about restrictive practices between parties in vertical relationship from the rule about horizontal restraints. The competitive effects of vertical agreements are a lot

more complex and thus they are usually assessed under a rule of reason. In jurisdictions where the law prohibits restrictive agreements without distinction, difference in their likely effects must be recognised or developed through enforcement practice of guidelines. Under South Africa's statute, a vertical agreement is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party can prove that any technological, efficiency, or other pro-competitive gain resulting from that agreement outweighs the anti-competitive effect, as can be seen in Section 5(1) of the act (Republic of South Africa, Competition Commission, 2001). Thus finding a violation usually depends on showing an actual anti-competitive effect. This final comment that was found in the act on whether there might be a violation would be as mentioned very difficult to actually prove and would only be answered after the appeal that might take place in the future.

Another problem that would be a possibility to investigate would be the fact that would there be the possibility for the abuse of dominance in this market if the deal would have given the green light? According to Section 7 of the Act it was found that any firm that actually has market power is considered dominant, regardless of its market share. The definition of market power includes concepts from the EU's definition of dominance: "the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent in dependently of its competitors, customers or suppliers (Republic of South Africa, Competition Commission, 2001). A merger may also be approved, or disapproved, based on "substantial public interest grounds." The public interest grounds are very broad, but they are not unlimited, based on the effect it may have on a particular sector or region, employment, the international competitiveness of South African industries, or the ability of small business or firms controlled by historically disadvantaged persons to become competitive. The public interest considerations are independent on those based on competition and efficiency and they are equally important. A merger that raises no competition policy concerns may still be barred because of other public interest considerations. According to the Organisation for Economic Co-operation and Development Peer Review of May 2003 (OECD Review), at least one merger has been permitted only after the parties accepted conditions related to employment security, despite a finding that the transaction raised no competition concerns. Considerations of the public interest often appear along with arguments about efficiency. The Tribunal has permitted otherwise anti-competitive mergers where there were strong showings of productive efficiencies that would outweigh the anti-competitive effect. Public interest concerns have

been prominent in decisions about others, but they were not necessarily reasons to permit them.

The next focus of this paper was levelled against the finding of any similar type of scenario's or proposed deals that have taken place anywhere else in the world. The most difficult part of it all was the fact that every company as well as every Securities Exchange around the world are different as well as having various different rules & regulations within their sectors. It was decided to focus mostly on emerging markets with just looking for any small similarities in the developed countries. The investigation started in looking at what have happened in the Australian market. Fundamentally, "front-line" regulatory responsibilities in Australia sit with the market operator. This structure is underpinned with the view that there are real advantages to having a market operator with public regulatory responsibilities that is able to use its closeness to the market to monitor broker activity and to intervene very quickly as required (Lucy, 2004). The Australian market concise of the Australian Stock Exchange (ASX), as Australia's premier capital market, which first raised the complex set of demutualisation-related issues that can be regarded as more or less the same as of what was experienced in the South African share industry. The ASX experience, however, has close parallels to the other major market in Australia, namely the Sydney Futures Exchange (SFE). The ASX operates Australia's primary national stock exchange for equities, options and fixed interest securities. The SFE on the other hand, provides futures and options on the four most actively traded markets namely: interest rates, equities, currencies and commodities and is the 10th largest financial futures and options exchange in the world by volume turnover (ASX, 2004: no page). Both the ASX and SFE are demutualised markets, with the ASX demutualising in 1998 and the SFE in 2000. Both the ASX and SFE are public companies with shares trading on ASX's markets. Both ASX and SFE operate and manage their own clearing and settlement facilities, as well as that both are obvious significant global links. The very interesting part of it all is that neither ASX nor SFE have ownership links with other exchanges.

Soon after ASX's listing it became clear that Australia had indeed embarked on an adventurous journey as ASX surged forward with a number of commercial initiatives that gave rise to regulatory challenges. This were more-or-less the exact time where it all got more interesting with ASX's announced takeover bid for the SFE, during the month of December 1998. In May 1999 Computershare, a public listed company on the ASX, announce a rival bid for the SFE (Lucy, 2004). A major conflict of interest had arisen and the sharp question that

the ASIC as regulator have asked was: "What arrangements can we put in place to ensure that the supervision of Computershare as a listed entity is not seen as tainted by the obvious conflict between ASX's role as a market supervisor and its interests as a potential commercial competitor?" At that specific moment, did the legislation not dealt with this potential situation and a regulatory response was therefore required. Accordingly, both parties entered into an agreement with ASIC which provided that, until the issue of the rival bids was resolved, ASX would not make any substantive decision about Computershare without consulting ASIC and acting in accordance with the advice provided by ASIC (Lucy, 2004).
This purely contractual arrangement was made public and details released to the market. Incidentally, neither ASX nor Computershare succeeded in their bids and SFE remains independent today. It is therefore very clear from the Australian story, that in an environment of market demutualisation, regulators need to be prepared to quickly respond to conflict and other issues that might arise from the demutualised entity pursuing its own commercial objectives. These issues would not always be obvious in advance and may arise very quickly without prior warning from any of the parties, simply through the pursuit of legitimate commercial opportunities (Lucy, 2004).

While conducting further research within the develop countries, the following were found within the United States securities industry in work done by Rajan (1995). He found that there were some arguments for allowing (prohibiting) banks into (from) the securities business are actually important, because they have intrinsic merit. Others have gained popularity (and hence importance) because they seem to have undeniable merit when viewed from the perspective of undergraduate economics i.e. in a world where most technologies and markets are competitive and information is publicly and freely available. While this may indeed approximate reality in the U.S., it is not at all obvious that it does in other countries.
In the U.S. the securities business have always been viewed as businesses just generating profits. In research done by Hayes and Spence (1983), they found evidence that security firms have market power in the United States. Presumably in less developed economies, security firms may have even greater market power. But it does not immediately follow that the entry of commercial banks into business will make financing more competitive.
The biggest hurdle that was experienced in the UK Securities Industry was the concern of the possible conflict of interest a bank or any financial institution faces when it is allowed to both lend to as well as underwrite for a company. The biggest question that can be raised here is whether a commercial bank is exploiting its role as lender and underwriter to force a company

to issue public securities and use the proceeds to repay the bank loan. The bank may therefore indirectly shift the risk of a bad loan from itself to the market Hebb (2000).
The dual role of lender as well as underwriter can therefore be clearly identified. The same question can therefore also be asked within the South African industry: Is it possible being a regulator and service provider in the same industry?

The ethical perspective as well as the possibility Corporate Governance would play in this was the next level of investigation. Another way of looking at what have happened in Australia and that what might have been happening in the share- or securities industry, the way of analysing the transactions or proposed transactions, is to look at it from the responsible side of Business Ethics. The following model will show the different layers of responsibility of ethics there may be. They would form the core part in addressing all business decisions when looking at them from an ethical perspective. True market reform requires self-imposed control in the top layer – individual action – where the issue is whether conduct is ethical, not whether it is ethical. The next two levels would be Company Regulations and the last layer would be Government and System regulations. When all the systems are installed at each level, we are ultimately dependent on individuals to exercise ethical courage and leadership in their companies and the big industry. Big-name lawyers as compliance chiefs and management consulting firms creating ethics programs are not substitutes for individuals with ethical spines (Jennings, 2005).

The Corporate Governance involvement was dealt by Reddy (2004), where it was found that the quality of corporate governance is a function of the quality of the overall control architecture. Control architecture may be defined as a framework or grid that provokes and canalises behaviours of various players within the system. The framework consists of regulators, government, institutions such as stock exchanges, judiciary, enforcement agencies, shareholders meetings and the Boards i.e.: all those that determine the macro-conditions relative to regulation, legal infrastructure, informational infrastructure and market infrastructure as well as the bodies implicit in law relating to joint stock companies. There is no uniquely good control architecture, despite the popular conception of the "outsider" / market model advanced by researchers particularly of the World Bank. He further mentioned that at the same time, there is no other robust framework that can be used as an international standard. Thus, the control architecture has to be uniquely adapted to the economic and developmental contexts of the country and is steered gradually and sensitively. Corporate

governance literature has popularly advocated the benefits of private ownership of financial institutions and how government ownership can induce inefficiency, politically directed inappropriate lending; conflicts of interest between the bureaucrats and the managers; conflicts of interest between the regulators and the regulated; abuse of office and lastly corruption. Reddy (2004) have found that research is being cited to show as to how government ownership weakens incentives and curtails competition while tolerating inefficient government directives as well as political patronage.

The other challenge has been to sensitise and manage conflicts of interest, which have particular importance in the financial sector. For reasons of opacity, informational asymmetry and aggravated agency issues, the scope for profiteering form conflicts of interest are enormous. Research used by Reddy (2004) regarding Corporate Governance, shows that the indicators formulated by Crockett (2004) regarding conflict of interest which has been recognised in basically four areas i.e. "underwriting and research in investment banking; auditing and consulting in accounting firms; credit assessment and consulting in rating agencies and the universal banking sector." In this work Crockett (2004) defines conflicts of interest as follows: "Conflicts of interest arise when a financial service provider, has multiple interest which create incentives to act in such a way as to misuse or conceal information needed for the effective functioning of financial markets".

When looking at all the happenings in the market, a clear direct connection can therefore be made where some of the above happenings occur in the transaction mentioned earlier with ASX and Computershare in Australia. Even though it was not clearly stated, one could easily see the conflict of interest that actually did arise there due to the ownership of equity by regulators as well as the employment of regulators by the private sector, to name one.

As South Africa forms part of the emerging market sector, one would ask you the question on how to deal with these issues on the way forward. Reddy (2004) found that there are regulatory overlaps/gaps as also laws that do not support the popular expectations for good corporate governance. These may accentuate conflicts of interest, regulatory arbitrage and the exploitation of legal lacunae to perpetuate poor standards of governance. In the sum, conflict of interest cannot be eliminated fully. However, proactive measures by the government and regulators by establishing norms for separation of functions/activities; supervisory oversight and mandatory disclosure are probably more appropriate for the developing economies which cannot as yet hope for market imposed discipline. Corporate governance therefore revolve around the following challenges namely; information flow and conflicts of interest. While the

efforts of the multilateral and international organisations are very helpful in establishing the structures, standards and flow of information, the challenge for developing countries continues to be those of actual changes in practices and of capacity to use this information meaningfully. At the same time, conflicts of interest exist particularly in four areas and these can be resolved through a combination of approaches. Of these, it is probable that developing countries will have to continue to rely on structural separation of functions and activities; supervisory oversight; as well as mandatory disclosures in that order of priority, as market discipline is still a distant possibility.

Conflicts of interest are built into the structure of our financial institutions because they typically provide multiple services to multiple clients. Although some conflicts can be reduced, the cost of doing so is often less than the benefit of having large, comprehensive financial institutions. The main challenge in the financial services industry, therefore, is to manage conflicts by such means as adequate disclosure and effective rules and policies (Boatright, 2001). In the research done by Boatright (2001) regarding Conflicts of Interest in Financial Services, he is building on a distinction made by Kevin McMunigal (2001) between two kinds of conflict of interest rules in the legal profession, namely rules for preventing harm and rules for reducing risk. Generally speaking, the approach in the professions, especially medicine and law, has been to protect clients and patients against any harm from conflicts, primarily by adopting rules against acquiring adverse interests. However, it is not always possible, or even desirable to seek the elimination of all harm. We brave many risks in order to enjoy gains. Investment, in particular, can never be risk-free and indeed risk in inversely correlated with return. The aim in financial services, therefore, is to manage risk prudently, including the risk that comes from conflicted financial service providers.

In looking at all these scenario's one can't help but asking yourself the question as to what now as well the question on how would it possible to deal with these ethical dilemma's that might occur from time to time? In work done by Caccase (1997), he has found that although having high ethical standards that far exceed the legal requirements, is it very important to have additional steps that need to be followed. He calls it the three-legged stool namely: high barriers to entry, ongoing education about and promotion of the highest ethical standards and an effective and fair enforcement program.

- High barriers to entry – Only persons of high moral character should be able to become professionals within the financial services environment.

- Education – Ongoing education and promotion of the highest ethical standards is accomplished through requiring continuing education in order to maintain membership. Associations actively encourage their governments and regulators to enact laws and regulations that help ensure ethical practices. Some have taken on the role of being governmentally recognized self-regulatory organisations.
- Enforcement – The best code of ethics, the highest barriers to entry and a superb education program cannot prevent ethical breaches unless ethics violations are costly for the perpetrator. Enforcement should be a last resort, but it is an essential element in maintaining ethics in the marketplace (Caccase, 1997).

Caccase (1997) further mentioned that the former U.S. Supreme Court Justice Potter Stewart had the following to say, speaking to a group of lawyers in defining ethics as "knowing the difference between what you have a right to do and what is the right thing to do."
Some people believe that if something is legal, it is ethical. This is on itself in answering this statement, a whole new research on its own and would therefore remain an unqualified and unanswered statement. Ethics is not simple. You not only have to know the right thing to do but also have the moral fortitude to do it. Being ethical is not always easy, especially in the very wide dimensions of any financial services initiative or division.

The research was conducted with the preparation of eight properly structured questions and the information was gathered through personal interviews. Unforeseen circumstances nearly created havoc during the gathering of information at the point in time where the topic became a "hot potato". Unfortunately were the last of the interviews set up during the same month as the ruling by the Competition Commission, which was expected to be announced regarding this proposed deal. No comments could therefore be obtained from the direct related parties in the transaction, namely STRATE as well as Ultra Registrars. Interviews were therefore conducted with the related CSDP's, brokers as well as listed Companies listed on the JSE.
At the point of time of gathering information for the research, there were no clear indication that a deal or a proposed transaction like this one actually would happen. It was then decided to research the possibilities, if any, that situations like this might happen in South Africa, as discussed earlier, which have happened elsewhere in the world.

In summarising the research results it was clearly found that the majority of the stakeholders did feel that this proposed deal was not good for business in general, as well as that it wouldn't enhance any good for their industry as a whole. They all felt that Corporate

Governance were supposed to be always a cornerstone within the day-to-day running of business and strongly felt that this might not have been the case here.

The effect on what power can do as well as to how much power can be regarded as negative, was also thoroughly investigated, with consensus in the fact that no-one within a certain industry can be allowed to gain too much power without proper approval or buy-in of all the related stakeholders involved.

Another concern that was raised focussed primarily on the segregation of duties. It was mentioned that whenever a proposed deal like the one mentioned come to the foreshore, direct- as well as proper segregation of duties needed to be addressed and put in place, as this may lead to the possible conflict as to where a referee became all or a sudden a player as well. There was furthermore consensus in adding to the above comment that every industry needs good and proper competitive competition, but that the competition needed to be free and fair and that related parties not being able to gain an unfair advantage due to specific connections or lines of reporting that might be in place. Everyone was in agreement that proper regulation is needed that would coincide with the proper segregation of duties as those that were highlighted earlier.

Results form the interviews further showed that the main aim and focus within the securities market was the though of being to de sustainable, as each of the stakeholders felt that there was a considerable need to rethink their own individual positions within the market as such, as their were consensus that some of their roles might have changed in some drastic way towards the future of the market. All the interviewees agreed that each market participants still have a major role to play within the industry. There were total agreement that some of the roles might have changed as well as with the possibility that some of them might have to swap roles in the future. The researcher was of the opinion that there would be some sort of consolidation of functions as he thought there might be too many stakeholders involved in such a small market with a very low market capitalisation such as within the South African share transfer industry, but according to the above this seems as not a possibility at the moment. Some very interesting comments were raised during the conducting of the interviews regarding the comment about who would maintain information pertaining to shareholders if transfer registrars might not be required further. The bulk of the comments were formed surrounding the comment that definite roles within this industry will need to change, as mentioned earlier, to be able to accommodate al the relevant stakeholders for the future. With

the new rules and regulations that are around, would it be very difficult to maintain these kind of information as well as detail relating to information without someone like transfer secretaries, who is equipped to render the service as well as having the right amount of resources already in place to accommodate the request.

The vast amount of interviewees felt that this would always be a service or function that would be outsourced, as no company, in particular the biggest listed companies, would have the resources as well as knowledge to be able to conduct this service by themselves. They strongly felt that from a company perspective, that it would rather be better for the company to rather keep their focus on their core business and to keep on outsourcing these kinds of services instead of keeping them and doing it in-house.

All the interviewees felt that if transfer secretaries eventually might fall away, someone else would stood out and take over that function as it can be seen that neither of the interviewed stakeholders do see them fit to be able to take over that function as well. An opportunity might thus arrive for any company to come to the forefront in possibly taking over that function if that would happen one day.

All the interviewees had the concern that it can not be allowed for STRATE to compete within the market and they are collating all the data themselves. It was thus felt that this definitely might lead to conflict as well as unfair business practice within this industry.

Another issue that was raised was the question of costs? There was concern as to whether what would happen if STRATE decides to increase their fees with example 100%? A direct correlation could therefore be made regarding this comment and the comment that was raised earlier about having too much power in the same industry. In short to summarise this question it seems like everything boils down in the threat of STRATE having too much power and with the possibility of an unfair advantage or disadvantage to certain stakeholders within the securities market.

In concluding this paper, it could clearly be seen that when constructing such a deal or looking at the possibilities of constructing such a deal, focus needs to be aimed at looking at various factors as well as the analysis of a few scenarios. Furthermore it was mentioned earlier that financial sector supervision, in particular, is more rigorous and intensive than with any supervision in any other regulated sector. Just for that fact, the paper was drawn up to try and test it within the Securities market as such. Their research highlighted the fact that there is always a strong call for a regulator in any sector to be totally independent. This ruling or decision by the Competition Commission in the upholding of the proposed deal thus placed a

damper at the time on the possibility of further investigating the possibilities even further as well as into more detail.

A few amount of arguments surfaced during the conducting of the interviews as well as during the general discussions that took place during the past year regarding whether STRATE can be seen as the regulator or not. As can be seen with the information gathered, the overwhelming evidence appears to be that STRATE can definitely be regarded as the regulator within the securities market. They mentioned in adding further that once those laws are in force, regulators must be free to determine how to achieve these goals as well as the fact that they should be held accountable if they fail to achieve them.

It is therefore very clear through the above mentioned press releases that STRATE envisages supplying transfer secretaries, being now only Computershare, with a download of data on a monthly basis and through Ultra Registrars offers a real-time service identically to the initial product that Computershare have proposed through to STRATE, of which they initially refused to assist Computershare with. This was clearly highlighted in the gathering of information through the conducting of the interviews that the interviewees felt that with the allowing of the deal to go through, there would always be a certain element of worry whether the above happenings might eliminate competition and that there might have been increasing fears that this will lead to a monopoly run by STRATE, which in turn might also have far reaching effects that are not discussed further in this paper.

It became very much clear, when looking at the evidence that was conducted, that there are fear in the South African market dominance might happen through STRATE. The actual extent as of to at the exact level of fear, was not properly looked at and would fall outside the borders of this specific research paper. In looking at the above, would it therefore be possible to assume that each and everyone of the stakeholders interviewed had the opinion that they are afraid of the unknown, that they are afraid and not sure what STRATE's main aim might be with the market. They all see and feel that there might be a real fear for any party to dominate, given the fact that they are given the opportunity to gain too much power.

It became very clear while conducting the interviews that all but one supported the ruling in full that were made by the Competition Commission. It was therefore concluded that one of the main reasons were that it might create unfair business practice within the market, as well as the possible unfair advantage Ultra might have over the rest of the stakeholders. All the interviewees agreed that the industry needs firm competition in order to provide a service of

superior quality and properly defined within certain pre-determined sectors. No one would have lifted an eyebrow if another financial services company was the proposed buyer and no-one would have objected to that proposed transaction.

In summarising it becomes clear, given the fact the information that were collated, that the proposed transaction never seemed to be on track for success from the beginning. It is not clear whether the related parties were ill-informed by the response of the market or whether they underestimated the attempt during the submission to the Competition Commission of the opposing parties. It would therefore be unfair in making such a comment as neither STRATE nor Ultra Registrars, made use of the opportunity in giving their reasons and comments regarding the proposed transaction.

In analysing the situation from the one side, it seems quite clear that a chance was taken and it didn't succeed. The option thus remains there for STRATE to oppose the ruling and formally lodge an appeal. At the time of finalisation of this paper, STRATE or Ultra Registrars have not yet made it public of what their next step in this would be. A clear indication on what their next step would be is expected by the market before the end of the year as the appeal, if decided by them in doing so, would only be heard at the end of the first quarter of 2006, that in itself might be a bit damaging in order to still salvage the deal form going under in total.

This paper has the potential to be explored even further as well as having the possibility of being broken down in a few more direct research topics that focus on a specific arm within this industry. The difficulty of this specific research was clearly shown in the gathering of the research results due to the fact of the timing of the project ending within the same month as the ruling by the Competition Commission. The results would have been analysed from a broader perspective with the participation of STRATE and Ultra Registrars during the interview processes. At the end of the day was it possible to summarise the view the market had on this transaction as well as the markets opinion on certain key factors that have surfaced on a few occasions in the broader financial services market: i.e. Corporate Governance within the financial sector, accountability and the taking of responsibilities for your own actions, threats of being monopolised, possible monopoly creation as well as the strategic acquisition within the same market.

Further research can be undertaken that can help us understand the concept of whether all regulators needed to be independent as well as to "who needs to regulate who?"
The difficulty in this research, apart form the refusal to partake, was further due to the fact that no transaction like this proposed one have taken place within the financial services market, which made it difficult in collating all the relevant information.

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Appendices relating to the article

1. Questionnaire

1. STRATE and the JSE both determine the shape of the securities market. My view is that they draft the rules, they design the market, and they police the market. What is your opinion on the above comment?

2. Do you agree with the comment that the separation of regulation and participation is considered good corporate governance?

3. STRATE recently announce the acquisition of the controlling interest in Ultra. What positives or negatives do you see, if any in the market? Financial? Strategically?

4. In your view, who owns the information pertaining to shareholders? Is it the CSDP, the Issuer itself or the CSD?

5. In your opinion, what is the future role of the various market participants? e.g., Stockbrokers, Asset Managers, CSDP's, Transfer secretary's ext?

6. What do you think the future holds for people who refuse to hold their share in electronic form? How will this impact on your answers to the questions above? Is this an issue that you think the constitutional court should rule?

7. Currently the administration of shareholders information falls into the ambit of work done by the transfer secretaries. If market determines that registrars are no longer required, who will maintain this information and changes there to?

8. The issue of regulation is a much talked about subject. The current situation determines that STRATE and the JSE are SRO (self regulatory organisations). Yet the SSA (securities services act) allows both of them to enter into commercial activities. This will bring conflict. Do you think this state of affairs should be allowed to continue?

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Appendices

1. Questionnaire on interview with Tertius Vermeulen

1. STRATE and the JSE both determine the shape of the securities market. My view is that they draft the rules, they design the market, and they police the market. What is your opinion on the above comment?
   "Yes, I agree. With a new listing, the JSE makes the rules regarding fees, listing requirements as well as that the shares must be dematerialised in STRATE. The JSE is self-regulated as well as that they own 41% of STRATE. Between the JSE and STRATE, all the rules are been made."

2. Do you agree with the comment that the separation of regulation and participation is considered good corporate governance?
   "Definitely yes. To prove this one just have to go and look at the objectives of the Security Services Act: "To increase confidence in the South African financial markets by – requiring that security services be provided in a fair, efficient and transparent manner; and contributing to the maintenance of a stable financial market environment. "

3. STRATE recently announce the acquisition of the controlling interest in Ultra. What positives or negatives do you see, if any in the market? Financial? Strategically?
   "From a financial perspective it can be seen as negative because CSDP's would loose clients as well as that the CSDP's Regulator becomes also a Competitor with a possible unfair advantage. Strategically, CSDP's worked very closely with STRATE, but it would be difficult to disclose some strategically important points as they would be a competitor as well. It would be difficult to determine whether any disclosure would be to the benefit of the Market or for the benefit of them."

4. In your view, who owns the information pertaining to shareholders? Is it the CSDP, the Issuer itself or the CSD?
   "It is not the CSD who owns the information, but the shareholders and the CSDP's who owns it. The shareholder must provide the CSDP with the authority to

disclose information through to the issuers or CSD except information that can be disclosed as in conjunction with the Company's Act. "

5. In your opinion, what is the future role of the various market participants? E.g., Stockbrokers, Asset Managers, CSDP's, Transfer secretary's ext?
   "The opinion is that they all still have a role to play in the industry. The fact is that some of the roles might have changed a bit up to now.
   i. *A stockbroker transact on behalf of a investor, giving him advice and help in the buying and selling of securities*
   ii. *Asset managers would be the next step. They manage the asset on behalf of the broker.*
   iii. *CSDP is there to settle. Keeps the information of all shareholders and to make sure delivery and payment takes place.*
   iv. *Transfer Secretaries' roles are changing. Maintaining certificated register. Main role still to keep records for issuer and collating the information to the issuer that is now in different places."*

6. What do you think the future holds for people who refuse to hold their share in electronic form? How will this impact on your answers to the questions above? Is this an issue that you think the constitutional court should rule?
   "In the new South Africa we have freedom of choice. If somebody has no incentive to trade, there is no reason why he needs to hold his share in electronic form. They know if they want to trade it can only be in uncertificated form, but why force them if they are not interested in trading at all? By enforcing this people would go there themselves because their own option to make their own decisions is taken away? Make rather use of incentives to do change people point of view to change. No enforcement is needed."

7. Currently the administration of shareholders information falls into the ambit of work done by the transfer secretaries. If market determines that registrars are no longer required, who will maintain this information and changes there to?
   "As mentioned, the role of transfer secretaries has changed. Firstly the name must change, because it is no longer about the transfer of shares from A to B, because that is now being handled by the CSDP's. With six CSDP's around,

someone must still collate the information. The question is who to do it? Is it STRATE, but again, the question comes up if it is possible to be a player and referee at the same time, or must it be a CSR. What would the "R" stand for? Is it for Register or Registrar? If it is a registrar, then there is still a role to play as Companies would be able to choose their own registrar. With a register, everything be kept at one place, but the role would be a bit different as such what is happening worldwide with Computershare, to provide add on services to the register."

8. The issue of regulation is a much talked about subject. The current situation determines that STRATE and the JSE are Self regulatory Organisations (SRO). Yet the Securities Services Act (SSA) allows both of them to enter into commercial activities. This will bring conflict. Do you think this state of affairs should be allowed to continue?
   "No, it can not happen. If the Financial Services Board (FSB), have made a decision not to be a "super regulator", and that will allow SRO's in the market, would it be their responsibility to make sure that the entity or entities that are the SRO, not being allowed through the SSA, to get commercial. If they don't compete on the market and they have data, there would be no problem if they sell the data in the market at a pre-determined price. The FSB must therefore regulate and make sure that the pricing be regulated and to have control over the fact not to charge any extra-ordinary prices."

2. Questionnaire on interview with Pam Gishen

1. STRATE and the JSE both determine the shape of the securities market. My view is that they draft the rules, they design the market, and they police the market. What is your opinion on the above comment?
   "I do agree with the fact that they do police the market. The concept should not be allowed at all. I believe that it is an unfair practice and should not be allowed at all. A lot are being passed down as rules to the issuer and they just have to accept it".
2. Do you agree with the comment that the separation of regulation and participation is considered good corporate governance?

"Most definitely yes. A direct correlation can be drawn in that it is not possible for the chairman of the board to be able to be the Chief Executive Officer of the same board. This is the comerstone of good Corporate Govemance. The correlation can thus be drawn that you can not be allowed to participate and regulate at the same time."

3. STRATE recently announce the acquisition of the controlling interest in Ultra. What positives or negatives do you see, if any in the market? Financial? Strategically?
   "I see the only positive in this are for STRATE as well as for Ultra. Their can be no positives for any other stakeholder in this. I can't comment on the financial side as I'm not directly involved as well on the strategic side. I just don't agree with the transaction at all."

4. In your view, who owns the information pertaining to shareholders? Is it the CSDP, the Issuer itself or the CSD?
   "As far as I'm concern is the issuer the main and only owner of the information pertaining shareholders. Without the issuers there wouldn't have been shareholders in the first place. "

5. In your opinion, what is the future role of the various market participants? E.g., Stockbrokers, Asset Managers, CSDP's, Transfer secretary's ext?
   "The opinion is that they all still have a role to play in the industry. There is still a requirement to have each and every one of them. Their roles might have to be adapted as some of the models and functions of them might change.
   i. *There was always a rule that only stockbrokers can trade shares.*
   ii. *Asset managers control the destiny of people with the shares they have bought with the peoples' money. They can be seen as an investment opportunity and can thus not be seen as a service provider at all.*
   iii. *CSDP is required because you can't trade without a CSDP.*
   iv. *Transfer Secretaries' roles would always be there until such time that it will become mandatory to dematerialise shares. Then they would have to adapt their role that they are playing."*

6. What do you think the future holds for people who refuse to hold their share in electronic form? How will this impact on your answers to the questions above? Is this an issue that you think the constitutional court should rule?
"It would be very difficult to enforce it for the simple reason that a huge amount of shareholders do not have technology, most of them don't even know that they own shares. How would this rule affect them? You simply can't take those shares now away from them. They remain the legal owners of those shares. A lot of people are also not in the market to trade and would therefore have no contact with STRATE. This is no constitutional matter and need not to end there."

7. Currently the administration of shareholders information falls into the ambit of work done by the transfer secretaries. If market determines that registrars are no longer required, who will maintain this information and changes there to?
"This is a "catch twenty two" situation in my eyes as STRATE maintains the consolidation of all the registers. STRATE should not be the only one. They either need to co-own it or the Transfer Secretaries should be the only one, as it would most certainly help in the balancing of the share register as it is quite often out of balance at times."

8. The issue of regulation is a much talked about subject. The current situation determines that STRATE and the JSE are Self regulatory Organisations (SRO). Yet the Securities Services Act (SSA) allows both of them to enter into commercial activities. This will bring conflict. Do you think this state of affairs should be allowed to continue?
"Definitely not. The JSE owns 41% of STRATE and STRATE is the regulator within the securities environment. There are too many overflowing roles and that it is my view that they are "sleeping to many times in each others' beds". This will most definitely bring conflict and a certain unfair advantage to certain stakeholders within the same market. It is my view that if you go and look further as far as overseas, you will find that the regulator and other stakeholders are somehow connected, but here in South Africa they have to much power together, like for instance they sit on each others' boards for one. This can not happen at all and will most definitely not be good for the market and might bring fear to the

overseas investor as well as place a bit of a damper on any Foreign Direct Investment (FDI)."

3. Questionnaire on interview with Karin Griffin

1. STRATE and the JSE both determine the shape of the securities market. My view is that they draft the rules, they design the market, and they police the market. What is your opinion on the above comment?
   "I don't agree with this fully as everything that is designed, is with the total consent of all the stakeholders. Everything is done according to the rules that are placed out as discussed with all the relevant stakeholders. Everybody is given the chance to give input to proposed changes."

2. Do you agree with the comment that the separation of regulation and participation is considered good corporate governance?
   "Definitely yes. "

3. STRATE recently announce the acquisition of the controlling interest in Ultra. What positives or negatives do you see, if any in the market? Financial? Strategically?
   "As a shareholder of STRATE I do support the deal, but can't comment on it at this stage any further."

4. In your view, who owns the information pertaining to shareholders? Is it the CSDP, the Issuer itself or the CSD?
   "This information belongs exclusively to the issuer alone. From our side the information belongs to our clients only with written consent from the clients, can this information be used or sold for example on request of the issuer for beneficial ownership information."

5. In your opinion, what is the future role of the various market participants? E.g., Stockbrokers, Asset Managers, CSDP's, Transfer secretary's ext?
   "There are room for all players in the future; with the only thing that some of their functions might become blurred. Large global players would still want to contact a

sub-custodian, which they have appointed out of own choice, to act on their behalf in rendering them a service. One thing that seriously needs to happen is better co-operation amongst the above role-players in the future."

6. What do you think the future holds for people who refuse to hold their share in electronic form? How will this impact on your answers to the questions above? Is this an issue that you think the constitutional court should rule?
"The thing that would always stand out would be the fact that those people would never be able to trade their shares. The Constitutional Court must never force people to go electronic – they must only enforce people not to be able to trade if not electronic. No enforcement from the Constitutional Court would therefore be needed."

7. Currently the administration of shareholders information falls into the ambit of work done by the transfer secretaries. If market determines that registrars are no longer required, who will maintain this information and changes there to?
"The decision lies with the issuers. It would be for them to decide to be able to appoint an agent of choice. The decision might be to appoint the CSD or it might be any other agent of choice. "

8. The issue of regulation is a much talked about subject. The current situation determines that STRATE and the JSE are Self regulatory Organisations (SRO). Yet the Securities Services Act (SSA) allows both of them to enter into commercial activities. This will bring conflict. Do you think this state of affairs should be allowed to continue?
"There should be a definite segregation of duties. The regulator can not be able to compete with the organisation or organisations that are regulated, if the segregations of duties are not properly structured and in place. Currently the regulatory function does not report into management but a separate regulatory body appointed by the board."

4. Questionnaire on interview with Erica Bruce

1. STRATE and the JSE both determine the shape of the securities market. My view is that they draft the rules, they design the market, and they police the market. What is your opinion on the above comment?
   "I do agree with it under the following that they both make rules and everyone in the share market has to adhere to them. Secondly are they both companies, like with any company having the main goal of making money for their shareholders. The next problem I have with their rules and regulations are that they can never be hold liable for anything. It is definitely nice to have a company with no such risks in their myth. I can understand why the JSE have done it because the South African market is quite small and it is quite difficult from a cost perspective, to have a compliance element for each and every market. I have a problem with the collating of information as it takes out the confidentiality in it. Previously you had to get permission from another client to get information regarding their register. STRATE is currently collating everything and can sell it to anyone who is willing to pay money for it and that is very wrong to me as I believe those information belongs to my client and not to them. I believe that they have too much power to make so many rules as it forms part of their overall business model. We are trying to put up a user group within the brokers to act as a forum in going to the FSB where we would be able to complain about certain of the rules set out by the JSE and STRATE that can not be changed without proper consultation and consent. We are just trying to dilute their absolute power to a minimum. They must not be able to decide where our future is going. We as the direct part of the market must be able to decide on our future and to where it is going, not only them. The reality and problem with them policing the market at this point in time is to what can we do if STRATE then decide to double their costs – absolutely nothing!"

2. Do you agree with the comment that the separation of regulation and participation is considered good corporate governance?
   "Yes and no. I understand why it should be but there are cost implications to it and I don't know whether we can afford it at the moment. It's going to have to go in that direction at the end of the day, in spite of the costs involved, because at

the end we might sit with a monopoly and that is not what we want. In theory I definitely do agree with the comment, but I don't know if we can afford it. "

3. STRATE recently announce the acquisition of the controlling interest in Ultra. What positives or negatives do you see, if any in the market? Financial? Strategically?
   "For me it looks as if they are trying to build a monopoly. As a user thus, I do not agree with the transaction, because it seems as if they want to cut out the CSDP's out of the loop in saying that "rather come to me instead of the CSDPs'", and that I think is a big negative and wrong. In consolidating all the functions can't be good for business, it can't be good for employment and at the end of the day, and it can't be good for South Africa. Strategically and financially the biggest benefit would therefore fall only within the direct participants in this transaction and that would be solely STRATE and Ultra and to a lesser extent the JSE. I can't see any benefit to any of the other stakeholders involved. Another problem I foreseen is that at the end of the day STRATE and the JSE might become each others competition in deciding that they want to start another exchange. Nothing would be able to stop them from doing that as they would have all the relevant registers, information, cash as well as the infrastructure to be able to handle that. That is another discussion and might be scary."

4. In your view, who owns the information pertaining to shareholders? Is it the CSDP, the Issuer itself or the CSD?
   "In the old days when everything was certificated, the transfer secretaries also didn't own the information, they just maintained on behalf of the issuer. I can't see that that have changed now that everything is so called electronic? Instead of the transfer secretary doing the maintenance previously, now it is the CSDP's. The issuer still owns the information fully. A Central Register (CSD) would therefore want to know who owns whom. I fell that it is my information and that it must belongs to me and not within a central register. I want to be able to choose who would maintain my information. This might lead to market manipulation when everyone knows who owns Sanlam shares for instance. That information might be used in the future in order to manipulate your shareholding within a certain sector. This is of course just speculation, but it will always remain a possibility that might

occur one day if this deal might have been given the green light. The point of the fact remains that if STRATE or the CSD owns that information, guess what would have happened if they for instance sell those information to the banks or to investment portfolio analysts?"

5. In your opinion, what is the future role of the various market participants? E.g., Stockbrokers, Asset Managers, CSDP's, Transfer secretary's ext?
"Definitely, everyone's role has changed drastically. Day-by-day trades might happen and small groups of asset managers might surface whereby each and everyone have a core of investors that would make it easier and more cost effective to trade. There might also be an interchange of functions where asset managers might become stock brokers and certain stock broker might become asset managers. The whole market might evolve into a "One-stop Financial Services Shop".

6. What do you think the future holds for people who refuse to hold their share in electronic form? How will this impact on your answers to the questions above? Is this an issue that you think the constitutional court should rule?
"No, not at all. The people who owns share certificates at this stage are ten to one people over eighty years old, who are no interested in trading as well as people who don't have access to infrastructure or who don't know about their shareholding at this stage. Why change that? The rule is already in place that if you want to trade, your shares have to be in electronic form and that is enough. The only risk here is from a fraud perspective alone. The constitutional court should therefora not get involved in this is this is a part of freedom of choice."

7. Currently the administration of shareholders information falls into the ambit of work done by the transfer secretaries. If market determines that registrars are no longer required, who will maintain this information and changes there to?
"I don't think the Company would do it just out of a resource and time perspective as well as that a whole new department needs to be employed but also, the Company would no longer be able to just focus on their core business. They would therefore make an attempt to rather outsource the function and keep on focussing on their core business. The JSE would also be able to do it. I am of the

opinion that everything should be able to stay the same as each and everyone have its own function within the market as it is and with time they would keep on evolving in order to keep up with the requirement that might arises. The problem that I foresee here is that you must avoid trying to build an elephant by inflating it and by keeping building it up, that might explode later."

8. The issue of regulation is a much talked about subject. The current situation determines that STRATE and the JSE are Self regulatory Organisations (SRO). Yet the Securities Services Act (SSA) allows both of them to enter into commercial activities. This will bring conflict. Do you think this state of affairs should be allowed to continue?
   "No, not under the current circumstances as I see as mentioned earlier that there are huge conflicts surfacing with the possible inception of this structured deal. The main conflict arises from the fact that what would happen if STRATE and/or the JSE would decide to increase their fees by 100%? What can you do, as who is regulating the regulator and under what set of rules? Each one would be affected by that and you would have no feet to stand on in order to defend such a kind of decision. You can not be the player in the same game where you are also the referee. That's just not on."

5. Questionnaire on interview with Andrew Johnston

1. STRATE and the JSE both determine the shape of the securities market. My view is that they draft the rules, they design the market, and they police the market. What is your opinion on the above comment?
   "STRATE and the JSE can be seen as regulators. The JSE together with the Commercial Banks are majority shareholders in STRATE. The JSE draft the rules regarding listing requirements, but is empowered by the Security Services Act. He sees STRATE as an affiliation of the Stock Exchange. I don't think STRATE designs the market; they are very much influential though in the design. JSE does police the market, but not STRATE to the same extent as such."

2. Do you agree with the comment that the separation of regulation and participation is considered good corporate governance?
   "Absolutely yes. Some one needs to regulate the regulator. You can't have both. You can't become a participant in the market where you play to the lesser extent, some sort of regulatory activity."

3. STRATE recently announce the acquisition of the controlling interest in Ultra. What positives or negatives do you see, if any in the market? Financial? Strategically?
   "Subsequent the subsequent deal has been stopped by the Competition Commission from taking place. I believe very strongly that the regulator can not become a player in the same market. Another negative might be that favouritism might occur within the market where Ultra might have an unfair advantage regarding receiving information possibly a lot quicker than the rest. A positive might be that strong competition is always good for any market, but not under this proposed deal."

4. In your view, who owns the information pertaining to shareholders? Is it the CSDP, the Issuer itself or the CSD?
   "This can be answered by looking at the Company's Act. It places all the obligation and onus upon the issuer alone. The shareholders of the Company become the main stakeholders within the Company. The Company itself by law have to maintain those relationships with the shareholders. The Company outsource the maintenance of those information to CSDP' or Transfer Secretaries, but still owes the information. The CSDP or Transfer Secretary only maintains the information on their behalf. The CSD is just the summary of all the information maintained by all the various CSDP's and thus also, doesn't own any of it."

5. In your opinion, what is the future role of the various market participants? E.g., Stockbrokers, Asset Managers, CSDP's, Transfer secretary's ext?
   "The opinion is that they all still have a role to play in the industry. There is still a requirement to have each and every one of them. The fact is that some of the roles might have changed a bit up to now.

i. *A stockbroker transacts on behalf of an investor and can be seen as the direct link with the shareholder or investors.*
ii. *Asset managers would be the next step. They manage the asset on behalf of the broker.*
iii. *CSDP is there because of STRATE. Can also be seen as an extension of the Company as it manages the shares that have been dematerialised into electronic form.*
iv. *Transfer Secretaries' roles can be seen as an extension of the company's arm. Maintaining certificated register. Maintenance of the Company's register and is doing it on behalf of the Company."*

6. What do you think the future holds for people who refuse to hold their share in electronic form? How will this impact on your answers to the questions above? Is this an issue that you think the constitutional court should rule?
"There are definitely no constitutionalities about it. The only law at this moment says that if you want to trade shares then you have to dematerialise your shares, but you can keep it in paper if you don't want to trade at all. The only constitutionality that may play a role would be the cost of dematerialisation. The question might arise as to who would bare the cost, the issuer or the shareholder?"

7. Currently the administration of shareholders information falls into the ambit of work done by the transfer secretaries. If market determines that registrars are no longer required, who will maintain this information and changes there to?
"The Company's Act doesn't refer to Transfer Secretaries. They probably saw a gap in the market a started rendering their services to act on behalf of listed Companies in maintaining their registers on their behalf. It can be seen in the same way as if Companies have outsourced the maintenance of their registers to Transfer Secretaries.
If Transfer Secretaries would fall away one day there would be a palace revolt from Company Secretaries as they would have to find someone to do that function as they wouldn't have the resources at that stage to handle it. This is actually a long shot as if Transfer Secretaries would disappear; someone else would jump onto the fold in doing it."

8. The issue of regulation is a much talked about subject. The current situation determines that STRATE and the JSE are Self regulatory Organisations (SRO). Yet the Securities Services Act (SSA) allows both of them to enter into commercial activities. This will bring conflict. Do you think this state of affairs should be allowed to continue?

"This argument have already been pre-empted by the ruling of the Competition Commission. I sit on the Advisory Board of Computershare whereby we give as issuers in the market our input as listed companies of what is happening in the market and to what do issuers expect of the market. If the decision by the Competition Commission was to approve the deal, a lot of huge listed Companies would have objected and protested against the proposed deal. The main reason would have been as to who would be watching the watchdog. This will most definitely bring conflict. There is a definite role for all SRO's to revisit their position and role within the market."

6. Questionnaire on interview with Richard Samson

1. STRATE and the JSE both determine the shape of the securities market. My view is that they draft the rules, they design the market, and they police the market. What is your opinion on the above comment?

"Spot on. You are definitely right. They are involved in the drafting of the rules. People are asking the question that how can you be a CSD, still regulate and still be your own boss? How can you obey your own rules? STRATE might rule that the reason they must play some sort of regulator is because of the lack of competency at the FSB in doing it. The responsibility has thus been moved down to them by the FSB. Another question here would be that who would be regulating STRATE then, as the FSB is lacking the so called competence in doing just that?"

2. Do you agree with the comment that the separation of regulation and participation is considered good corporate governance?

"Yes, this should be so. The concern here is that Mr King who is sitting on that specific board doesn't seem to practice what he preaches as he has done in his report."

3. STRATE recently announce the acquisition of the controlling interest in Ultra. What positives or negatives do you see, if any in the market? Financial? Strategically?
   "A concern is raised here that they would become a competitor within the same market as the other stakeholders and it might seem as they might have an unfair advantage over the rest of the competitors."

4. In your view, who owns the information pertaining to shareholders? Is it the CSDP, the Issuer itself or the CSD?
   "The CSD most definitely doesn't own any of the information, as the CSD's function is only to move information around and collating it from others. The information belongs to the register as this would give the summary as to who owns what within a specific company. The CSDP only owns the relationship with the client, as he would always try and satisfied the need of the client first. The main function of the CSDP comes in here where they carry the information to the market to settle."

5. In your opinion, what is the future role of the various market participants? E.g., Stockbrokers, Asset Managers, CSDP's, Transfer secretary's ext?
   "When a proper CSD would be in place the role of the CSDP specific will change considerably as some of it functions would fall away and the size and functions of the CSDP's would drastically reduce. The asset managers and the stock brokers might still be there unchanged and it would be difficult to comment on the role of transfer secretaries as it is not clear to them of how they would be affected."

6. What do you think the future holds for people who refuse to hold their share in electronic form? How will this impact on your answers to the questions above? Is this an issue that you think the constitutional court should rule?
   "The industry has made provision for paper. It was stated right from the beginning that paper would always be regarded as valid. The only thing that have changed here was the fact that the rules were put down that in order for you to be able to trade, that it had to be in electronic form. People would always like to keep shares in paper form and they are obviously not serious investors as they are not interested in trading at all. You can not take away that right that he had.

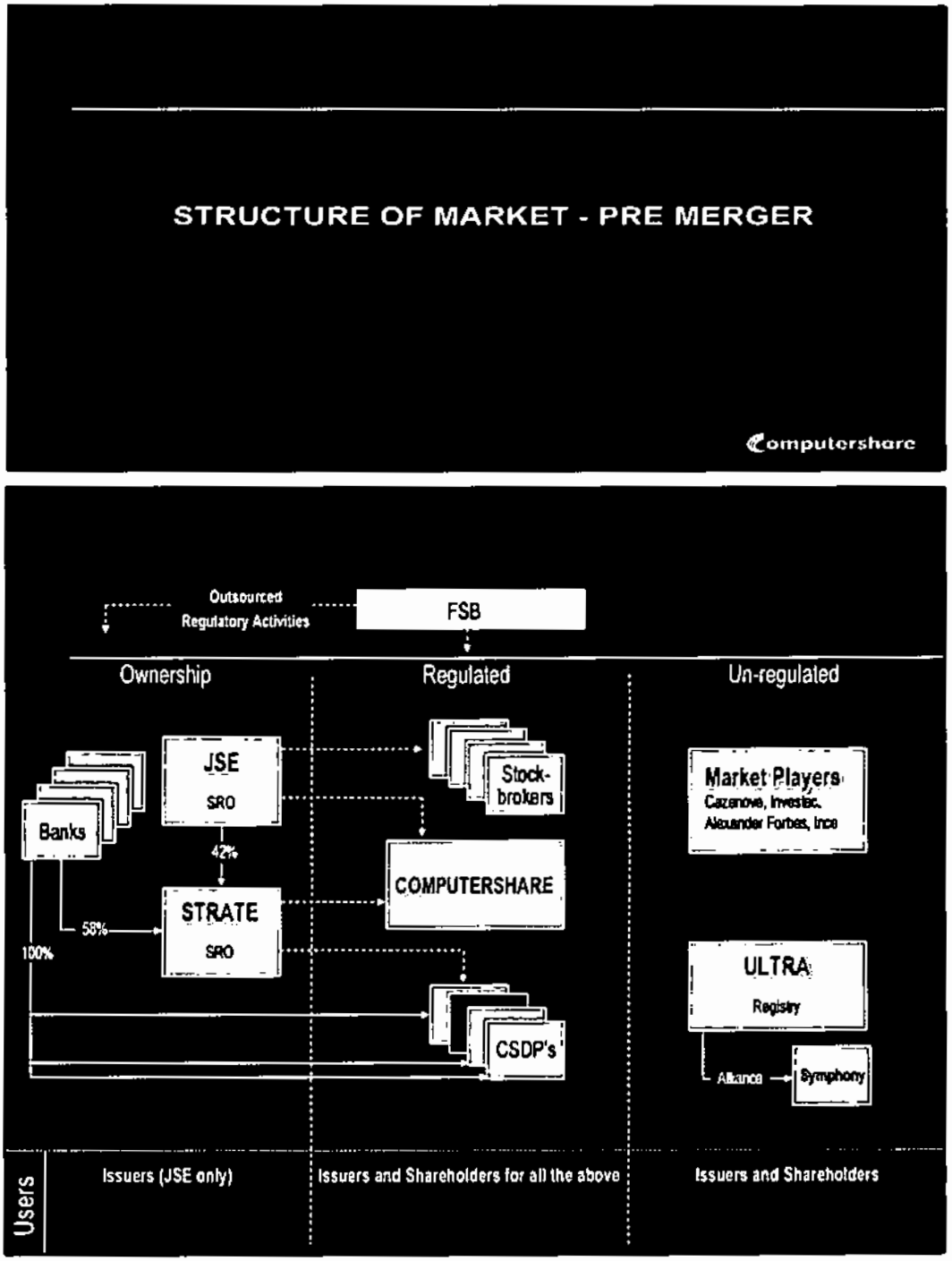
The electronic form would remain good as it would be easier to trace as well. This would also lead to the downsizing of the chances for fraud.
This can be regarded as the same as with title deeds. Title deeds don't need to be done on paper. It can easily be done. They main reason for this seems as if people like to have something to take possession of like with a certificate or title deed. This got nothing to do with the Constitutional Court, just as long as each and every person's right is not taken away."

7. Currently the administration of shareholders information falls into the ambit of work done by the transfer secretaries. If market determines that registrars are no longer required, who will maintain this information and changes there to?
"It is difficult for a CSDP to comment on this as CSDP's don't all know what the main role of any transfer secretary is. The main thing though is that I think that it would be difficult for anyone, like for instance the CSD, to take over that role because it is not clear as to whether they would want to have that role as well. The CSD want to take over the easy function within the market. They want to take over the portion with the best and highest margins that are the most profitable. It would be the same as if banks do take over companies but they don't want the bad debt."

8. The issue of regulation is a much talked about subject. The current situation determines that STRATE and the JSE are Self regulatory Organisations (SRO). Yet the Securities Services Act (SSA) allows both of them to enter into commercial activities. This will bring conflict. Do you think this state of affairs should be allowed to continue?
"No this can not be allowed to happen as there would most definitely be conflict. You can see it today between the JSE and the Bond Exchange, the JSE and SAFEX and so on. It all boils down to the question that if I want to become a commercial entity, the point needs to be understood that you can't be a regulator as well then. It is a concern that Mr King sits in a company who isn't practicing what he mentioned in his papers. Why? The FSB must therefore make up its mind. If they don't have the capacity to do it or the capability, then they must hire it and get it and take over that regulatory function it was suppose to take. Then

and only then would it be agreed upon that a transaction like this might be allowed to carry on."

7. Structure of the Market – Pre merger



8. Structure of the Market – Post merger

