

South Africa:

Risk & Compliance - Board Notice 52

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Collective Investment Schemes Control Act (45/2002): Financial Services Board: Determination on the Requirements for Hedge Funds.

On 6th March, the National Treasury of South Africa published Board Notice 52 - the Determination on the Requirements for Hedge Funds (BN52) which came into force on 1 April 2015.

Investment funds conducting the business of a hedge fund will now become collective investment schemes (CIS) and will be regulated by Cisca.

Board Notice 52:

Following the publication of the Declaration, specific requirements for hedge funds were published under Board Notice 52 in Government Gazette 38540 of 6 March 2015.

The Board Notice determines specific requirements and ongoing obligations with which a manager of a hedge fund must comply. The Board Notice determines two types of hedge funds, i.e. one for retail investors (Retail Hedge Funds) and the other for qualified investors (Qualified Investor Hedge Funds). The two types of hedge funds are regulated differently, with the Retail Hedge Funds regulated more strictly than the Qualified Investor Hedge Funds.

The specific duties and on-going requirements imposed on qualified investor hedge funds are less onerous than those imposed on retail hedge funds. A “qualified investor” is defined in the Requirements as being any person who will invest a minimum investment amount of one million Rand per hedge fund and who either has “demonstrable knowledge and experience” in financial matters thereby enabling the investor to assess the merits and risks of a hedge fund investment or has appointed a financial services provider with such knowledge and experience to advise the investor in relation to such investment. The obligation is placed on the manager of a qualifying investor hedge fund to obtain a declaration of eligibility from each qualified investor.

Managers of retail hedge funds are required to comply with detailed counter party exposure restrictions, prudential asset class requirements and specific derivative requirements including an ability for any over-the-counter derivative to be valued.

General requirements applying to both qualifying investor hedge funds and retail hedge funds include a defined list of derivative counter parties, the requirement for an established remuneration and reward policy and a prohibition on naked short selling.

Compliance with the Requirements by a manager of a hedge fund existing at the date of the commencement of the Requirements is effective from the date 12 months after the registration of the person as a manager of a hedge fund.

Any person conducting the business of a “hedge fund” as defined in the Determination is required within six months from 1 April 2015 to lodge with the Registrar of Collective Investments an application for registration as a manager of a hedge fund in terms of CISCA.

Qualified Investor Hedge Funds:

A “qualified investor” is defined in the Requirements as being any person who will invest a minimum investment amount of one million Rand per hedge fund and who either has “demonstrable knowledge and experience” in financial matters thereby enabling the investor to assess the merits and risks of a hedge fund investment or has appointed a financial services provider with such knowledge and experience to advise the investor in relation to such investment.

There are limitations on investment strategies that expose an investor to a loss in excess of the value of its investment or contractual commitment to a fund.

The fund manager must set a “value-at-risk”, which is a measure of the maximum expected loss of a portfolio at a given confidence level over a specified period.

Have sufficient liquidity for the relevant portfolio of the QI fund that enables the manager to pay out investors within three months of an instruction to sell.

Retail Hedge Funds

A retail fund does not have the above restrictions. Generally speaking, retail funds must comply with more detailed regulatory requirements, including detailed prudential investment requirements.

Managers of retail hedge funds are required to comply with detailed counterparty exposure restrictions, prudential asset class requirements and specific derivative requirements including an ability for any over-the-counter derivative to be valued.

Liquidity - The fund must have sufficient liquidity to enable its manager to pay out investors within one month of receipt of an investor instruction to repurchase.

The fund manager is limited to borrowing up to 10 percent of the value of a portfolio for liquidity purposes.



Counterparty-exposure - A manager must limit the counterparty exposure of a portfolio to the net asset value of the portfolio per one counterparty subject to the following:

- 10% per security or 30% per security as long as the limits aggregate excess exposure above 10% is limited to 40% of the net asset value of the portfolio;
- the aggregate (transferable equity securities, money market instruments, or deposits) exposure per counterparty must be less than or equal to 30%
- a maximum 20% in aggregate in securities based on the value of gold, other metals, and commodities if the securities are listed on an exchange
- a maximum of 20% in unlisted transferable equity securities as long as these securities are negotiable, can be independently valued, and do not compromise the ability of the portfolio to meet its liquidity terms.
- maximum of 10% in any other securities or assets

Collateral - A manager must ensure that sufficient collateral arrangements are in place. Collateral must be sufficiently liquid to ensure that it can be converted to cash within seven days in an default event at a price that is close to its pre-sale valuation.

Permitted assets and securities - A manager may only include investments in other retail hedge funds or in collective investment schemes in accordance with the exposure limits set out below:

Where a retail hedge fund invests in other portfolios,

(a) investment in any one portfolio may not exceed 75% of the market value of the portfolio;

(b) it may invest in participatory interests issued by a fund of funds only if that fund consisting of other portfolios is domiciled and regulated outside the Republic and where the fund consisting of other portfolios is not invested in another fund consisting of other portfolios or feeder fund.

(c) it may invest in participatory interests issued by a feeder fund only if the feeder fund holds assets outside the Republic of at least eighty five per cent of the value of the feeder fund.

Derivatives - If the portfolio includes derivatives, the manager must ensure that the fund's exposure to derivatives does not exceed the net asset value of the portfolio.

Exposure - A manager may calculate the portfolio's total exposure and leverage by either the value-at-risk approach; or the commitment approach. A manager using the commitment approach when calculating exposure must ensure that a portfolio's total exposure to the market does not exceed 200 per cent of the total net asset value of the portfolio.

Monthly reporting to the registrar - Managers must report to the Financial Services Board monthly, within 14 days of the end of the month, all long and short positions in the portfolio, reflecting the market value and the effective exposure and value of each of the underlying investments

All Hedge Funds

Quarterly reporting to the registrar – Managers of all Hedge Funds must within 30 days after the end of each calendar quarter, furnish to the registrar, in respect of each portfolio of the hedge fund that it manages, electronically or otherwise, a report containing a full list of all gross and net assets in the relevant portfolio, including all long and short positions, reflecting the market value of each asset and exposure included in that portfolio, with the value of each of those assets.



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