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GOVERNMENT NOTICE

NATIONAL TREASURY

No. R. 1256 30 November 2001

NATIONAL TREASURY
FINANCIAL SERVICES BOARD

UNIT TRUSTS CONTROL ACT, 1981

FINANCIAL INSTRUMENT REGULATIONS

The Minister of Finance has under section 42, read with section 6(1)(c) of the Unit Trusts Control Act, 1981 (Act No. 54 of 1981), made the Regulations in the Schedule.

SCHEDULE

1. DEFINITIONS

In these Regulations "the Act" means the Unit Trusts Control Act, 1981 (Act No. 54 of 1981), and any word or expression to which a meaning has been assigned in the Act, shall bear the meaning so assigned to it :

"ASSET PORTFOLIO", in relation to a unit portfolio, means the portfolio of underlying assets forming the unit portfolio;

"CALL OPTION" means an option contract in terms of which the holder of the contract has the right, but not an obligation, to purchase the relevant underlying asset or to receive a cash settlement instead thereof;

"CONTRACT SIZE" or "MULTIPLIER", in relation to a financial instrument, means the factor by which the price of an underlying asset is multiplied to arrive at the value of one contract as specified in either -

(i) the rules of the relevant exchange on which the financial instrument is listed; or

(ii) the terms and conditions as defined in the offering document of the relevant instrument;

"DELTA FACTOR", in relation to a financial instrument, means the requirement for an exposure calculation for financial instruments as determined in accordance with -

(i) a method prescribed by the relevant exchange for the specific financial instrument; or

(ii) the terms and conditions as defined in the offering document of the relevant instrument;

"DELTA SIGN", in relation to a financial instrument, means the mathematical sign of the exposure of the financial instrument, determined by the sign of the delta factor, which can be either positive or negative, determined in accordance with -

(i) the delta factor calculation prescribed by the relevant exchange for the specific financial instrument; or

(ii) the terms and conditions as defined in the offering document of the relevant instrument;

"EXCHANGE", means a licensed financial exchange as defined in section 1 of the Financial Markets Control Act, 1989 (Act No. 55 of 1989) or a licensed stock exchange as defined in section 1 of the Stock Exchanges Control Act, 1985 (Act No. 1 of 1985);

"FINANCIAL INSTRUMENT" means-

(1) an option contract as defined in section 1 of the Financial Markets Control Act, 1989;
(2) a futures contract as defined in section 1of the Financial Markets Control Act, 1989; or
(3) a warrant, index tracking certificate or instrument, based upon an underlying asset, declared to be a financial instrument by the Registrar of Financial Markets under paragraph (d) of the definition of "financial instrument" in section 1 of the Financial Markets Control Act, 1989, and which is listed on an exchange;

"LIQUID INSTRUMENT", for the purpose of permitted investment in financial instruments by unit portfolios, means the nominal exposure to liquid instruments as determined in regulation 6(1) and 6(2);

"NOMINAL EXPOSURE", in relation to a financial instrument, means the exposure as calculated in regulation 5(3);

"PUT OPTION" means an option contract in terms of which the holder of the contract has the right, but not an obligation, to sell the relevant underlying asset or to receive a cash settlement instead thereof;

"TRANSACTION SIGN", in relation to a financial instrument, means the transaction direction, whether buying or selling, of a financial transaction, as calculated in accordance with regulation 5(4);

"UNDERLYING ASSET", in relation to a financial instrument, means -

(1) any security;
(2) an index as determined by an exchange;
(3) a group of securities which is the subject matter of the financial instrument whether such group of securities is represented by an index or not; or
(4) in the case of a warrant, option contract or futures contract, any underlying asset referred to in paragraphs (1), (2) and (3).

2. INCLUSION OF FINANCIAL INSTRUMENTS IN UNIT PORTFOLIO

(1) A management company may include financial instruments in a unit portfolio, subject to these Regulations and the trust deed and supplemental trust deeds.
(2) In the application of subregulation (1) a management company may only sell option contracts which have previously been bought.

3. EXPOSURE LIMITS

(1) The sum of the nominal exposures to liquid instruments as a result of the inclusion of financial instruments in a unit portfolio, together with the market value of all the physical underlying securities in the unit portfolio, may not exceed 100 percent of the market value of the unit portfolio, or the nominal exposure may not have a value at any time less than that required by section 6(2) of the Act.

(2) The nominal exposure to financial instruments on any specific underlying asset, which is not an index or group of securities, together with the market value of any physical holding of that specific underlying security, may not exceed the limitations laid down in section 6(1) of the Act.

(3) For the purposes of this regulation, the provisions of subparagraphs (i) and (ii) of section 6(1)(a) of the Act in respect of excesses which are due to appreciations or depreciations of the market value of the relevant securities, or an amalgamation, cession, transfer or take-over in terms of section 24 of the Act, apply *mutatis mutandis*.

4. MAINTAINING OF CERTAIN ASSETS IN UNIT PORTFOLIO

A management company which in accordance with the provisions of these Regulations -

(a) sells future contracts, sells call options or call warrants, or buys put options or put warrants, based on specific underlying assets which are not indices, shall maintain in the relevant unit portfolio a market value of such underlying assets with positive nominal exposures to the same underlying assets;

(b) sells futures contracts, sells call options or call warrants, or buys put options or put warrants, based on index futures or group of securities, shall maintain an exposure to appropriate underlying assets or other financial instruments with positive exposures to similar underlying assets, in the relevant unit portfolio which is at least equal to the nominal exposure of such financial instruments;

(c) buys futures contracts, buys call options or call warrants, or sells put options or put warrants based on any underlying asset, shall maintain an exposure to liquid instruments in line with nominal exposure prescribed in regulation 3(1);

(d) sells put options or put warrants may maintain a bought put option or bought put warrant only if the strike price of the bought put options or bought put warrants are not lower than the sold put option or put warrant in place of liquid instruments as required in regulation 4(c);

(e) sells call options or call warrants may maintain a bought call option or bought call warrant only if the strike price of the bought call options or call warrants are lower than the sold call option or call warrant in place of underlying assets as required in regulation 4(a) or (b);

(f) sells or buys multiple options or multiple warrants based on the same underlying assets and requiring nominal exposure to liquid instruments per regulation 4(c), may maintain liquid instruments as needed for only one such option or warrant transaction; and

(g) sells or buys multiple options or multiple warrants based on the same underlying assets and requiring nominal exposure to underlying assets per regulation 4(a) or (b), may maintain such instruments as needed for only one such option or warrant transaction.

5. CALCULATION OF NOMINAL EXPOSURE TO UNDERLYING ASSETS IN UNIT PORTFOLIO

(1) The exposure of a futures contract or index tracking certificate to an underlying asset, group of underlying assets or an index shall be calculated as the product of:

(a) The number of contracts.
(b) The relevant contract size.
(c) The current market value of the underlying asset, group of underlying assets or an index.

(2) The exposure of an option contract or a warrant to an underlying asset, group of underlying assets, an index or an index future, shall be calculated as the product of:

(a) The number of option or warrant contracts.
(b) The relevant contract size.
(c) The current market value of one relevant underlying asset, one group of the underlying assets, an index or index future.
(d) The delta factor being one.

(3) The nominal exposure to any financial instrument shall be calculated as the product of:

(a) The exposure, calculated in accordance with regulation 5(1) or 5(2).
(b) The transaction sign.

(4) The transaction sign is positive for any financial instrument purchased and negative for any financial instrument sold.

(5) The nominal exposure to financial instruments on any underlying asset is the sum of the nominal exposure of all financial instruments on the underlying asset.

6. CALCULATION OF NOMINAL EXPOSURE TO LIQUID INSTRUMENTS ASSOCIATED WITH THE FINANCIAL INSTRUMENTS ON UNDERLYING ASSETS IN UNIT PORTFOLIO

(1) The nominal exposure to liquid instruments of any financial instrument required in accordance with regulation 4 shall be calculated as the nominal exposure of any financial instrument calculated in accordance with regulation 5(3).

(2) The nominal exposure to liquid instruments for the unit portfolio shall be calculated as the sum of all the liquid instruments' nominal exposures calculated for all financial instruments in the unit portfolio in accordance with regulation 6(1).

7. REPORT BY THE INDEPENDENT AUDITOR

After the inclusion of a financial instrument in a unit portfolio, and while a financial instrument remains included in a unit portfolio, a management company shall furnish the registrar within 30 days after the last business day of each quarter with a report substantially conforming to Report A1, attached to these Regulations.

8. REPEAL OF REGULATIONS

The Regulations published by Government Notice No. R. 2193 in Government Gazette No. 15265 of 19 November 1993, are hereby repealed.

9. SHORT TITLE AND COMMENCEMENT

These Regulations shall be called the Financial Instrument Regulations, 2001, and come into operation on 1 December 2001.

REPORT A1

REPORT OF INDEPENDENT AUDITOR OF MANAGEMENT COMPANY IN RESPECT OF SYSTEM OF INTERNAL CONTROL

We have audited the system of internal control regarding .... (NAME OF UNIT PORTFOLIO), designed to ensure compliance by .... (NAME OF MANAGEMENT COMPANY) with the Financial Instrument Regulations, 2001 (the Regulations), promulgated under section 42, read with section 6 (1) (c), of the Unit Trusts Control Act, 1981 (Act No. 54 of 1981).

Compliance with the Regulations and the maintenance of an effective system of internal control is the responsibility of the directors of the management company. Our responsibility is to express an opinion as to whether or not –

- internal controls were suitably designed to provide reasonable assurance that they would, if operating as designed, prevent of detect any non-compliance with the Regulations;
- the internal controls operated as designed throughout the quarter ended ....

Because of inherent limitations in any system of internal control, errors or irregularities may occur and not be detected. Also, projections of any evaluation of the internal controls to future periods are subject to the risk that the system of internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We conducted our audit in accordance with generally accepted auditing standards. These standards require that we adopt procedures to obtain an understanding of the system of internal control designed to ensure compliance with the Regulations, to evaluate the adequacy of the controls and to test the operating effectiveness of those controls. We consider that our auditing procedures were appropriate in the circumstances to express our opinion presented below.

In our opinion –

- the system of internal control over compliance with the relevant Regulations was suitability designed to provide reasonable assurance that the controls would, if operating as designed, have prevented or detected non-compliance with the Regulations;
- the system of internal control designed to ensure compliance with the Regulations, operated as designed throughout the quarter ended ....

Without qualifying our opinion above, we draw attention to the following instances of non-compliance with the Regulations which were/were not subsequently corrected:

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Date
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