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Title: JSE passes the buck by not doing enough to protect bond investors

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JSE passes the buck by not doing enough to protect bond investors

● *Exchange agrees to better reporting but balks at making place for independent trustees*

In an age in which self-regulation has usually been a failure, the role of the JSE looks like an anachronism. After all, the exchange isn't a not-for-profit industry co-operative like a law society or bar association, but a for-profit listed company. Even Warren Buffett says a stock exchange shouldn't be in the business of making profits – it just needs enough fees to wash its face. As a listed company, the JSE needs to keep the trades in equities, bonds and derivatives pumping.

The Financial Sector Conduct Authority is becoming an ever more intrusive regulator of unit trusts and insurers and is now responsible for the market conduct of banks, yet it is happy to leave the JSE to its own devices. A market by its definition is an amoral actor in the economy, there to grease the wheels of commerce.

Futuregrowth, as the largest private sector investor in bonds, has not been happy that the governance of the bond market lags behind even the equity market.

BLATANT DISHONESTY

And equity markets have had their share of blatant dishonesty from companies such as Steinhoff. The JSE can't be wholly blamed for this, of course, but it has never taken any responsibility for any devious activities on listed company boards.

At least anyone who buys a share can enjoy almost unlimited upside or downside. Futuregrowth's head of credit, Olga Constantatos, says a bond is in effect a loan; it has limited upside and investors should be able to set their own terms for these loans.

Yet many bond issuers have not been competently managed and have been unable to meet their obligations, including parastatals such as Umgeni Water and private issuers such as PPC and African Bank.

She says there needs to be an



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improvement in the timing, frequency and nature of disclosure and reporting by bond issuers.

The JSE has at least agreed on this. Debt issuers have to make public their policies on conflicts of interest as well as the process of nominating and appointing directors at the parent company. There is also a need to disclose when a state-owned enterprise or municipality transacts with a domestic prominent influential person. This is a term used in the Financial Intelligence Centre legislation, covering prominent politicians and business people.

Constantatos accepts that the JSE has improved the regulation on bondholder meetings. She says that under the old rules Futuregrowth was unable to call a meeting when Umgeni went for months without directors.

And decisions are now made rationally, with votes based on the percentage of scrip held and no longer by a show of hands.

In many markets there is an independent bond trustee who can represent investors' views as well as playing a fiduciary role on behalf of the ultimate owners, mostly members of pension funds. The JSE doesn't believe we are ready for anything so sophisticated as it has opted for a new post with the dreary name of debt officer.

Usually, the finance director or treasurer of the issuing company would take this role, hardly an independent party.

Constantatos says the debt officer still doesn't facilitate the proper negotiation of legal terms and conditions in loan documents and can't ensure the issuers meet their investor



Exchanging views:

Observers question the status of the JSE as a listed company, saying its profit motive is in conflict with the provision of its services. /Financial Mail

obligations. This change was initially agreed by the JSE last October but is not included in the current proposals.

DLR is an appropriate acronym for the debt listings requirement as it also stands for Docklands Light Railway, the slowest and least efficient line on the London Underground.

Not only is there no proposed requirement for a bond trustee or legal adviser representing the investors in bonds, but the JSE has scrapped proposals to enforce transparency over the terms and conditions in the legal agreement between issuers and investors. And in the event of default, bond issuers are not required, like all other borrowers, to pay their own legal costs.

No doubt the JSE is terrified that if it makes conditions too

onerous, bond issuers will defect to the JSE's cheaper and less bureaucratic competing exchanges. But the JSE would not let Futuregrowth or any other asset manager have sight of its legal arguments.

REGULATIONS

The JSE believes it cannot get involved with commercial negotiations, but isn't that precisely what regulators are empowered to do?

It should certainly bring in all the regulations it needs to protect investors.

"Where commercial negotiations do not achieve an appropriate outcome there needs to be a regulatory solution," says Constantatos.

The new head of the JSE, Leila Fourie, seems to think she

was doing a favour by engaging in public consultations at all, and she has definitely dodged both the concept of an investor representative and the payment of legal costs by the issuer.

She believes that even without these developments the JSE has significantly enhanced corporate governance and disclosure. It has passed the buck on the remaining concerns to parliament, as Fourie believes such changes cannot take place without changes to legislation.

But Constantatos argues that the JSE is failing in its primary duty to create and manage a fair and level playing field where borrowers and lenders can meet, negotiate and transact.

● Cranston is a Financial Mail associate editor.