Notice Number: SECZ-SS07/07/2017

Capital Adequacy Directive

For

Securities Market Intermediaries (SMI)

July 2017

Introduction

Following further consultations and representations made by Securities Market Intermediaries, SECZ hereby cancels and withdraws the following directives:

- Public Notice Number: LD15/12/10 on preliminary Capital Adequacy
- Capital Adequacy framework for Investment Management Companies dated August 2014;
- Capital Adequacy Framework for Investment Advisory Companies dated March 2015; and
- Capital Adequacy Framework for Securities Trustees Companies March 2015

It is hereby notified that The Securities and Exchange Commission of Zimbabwe ("the Commission"), in terms of Section 21 of the First Schedule to the Securities and Exchange Act, Chapter 24:25, as read with the SIXTH SCHEDULE *(Rule 53)* of Securities (Registration, Licensing and Corporate Governance) Rules, S.I. 100 of 2010 issues the following Directive. The directive shall apply to the following Securities Market Intermediaries:-

- Securities Dealing (Stockbroking) firms;
- Securities (Brokers) dealers trading on his or her own account;
- Securities Investment (Asset/Fund) management firms;
- Securities Investment Advisory firms;
- Securities Trustees firms;
- Securities Custodial Firms;
- Securities Transfer Secretaries;
- Securities Exchanges; and
- Central Securities Depositories.

1. Short title

This directive shall be cited as the Securities and Exchange Commission **(Capital requirements for Securities Market Intermediaries)** directive 2017.

2. In this directive-

"Adjusted liquid capital" (ALC) means equity plus qualified subordinated liabilities and credits less (illiquid assets; most unsecured receivables; operational charges (fail-to deliver); and proprietary positions haircuts). ALC focuses on liquidity and is designed to protect investing public, counterparties, and creditors by requiring that SMIs have sufficient liquid resources on hand at all times to satisfy claims promptly and ensure that investors' securities and funds are adequately safeguarded. The primary purpose of ALC is to ensure that SMIs maintain at all times sufficient liquid assets to:

(i) promptly satisfy their intra and inter liabilities-the claims of customers, creditors, and among themselves;

(ii) provide a cushion of liquid assets in excess of liabilities to cover potential market, credit, and other risks if they should be required to liquidate.

"counterparty risk" means the risk of loss due to the inability or unwillingness of a counterparty to honour their obligations to deliver cash, securities or other assets as contractually agreed. Counterparty risk arises from trading, investment activities and products, and lending or underwriting.

Fail-to-deliver" means a situation in which the selling SMI does not receive securities from the client in time to make delivery with the buying SMI.

"Liquidity risk" means the risk of not being able to generate sufficient cash to meet its financial obligations when they fall due.

"Operational Expenditure (Fixed Expenditure Base) Requirement (OEBR/FEBR)" means the amount required to meet the Licensee's operational expenditure and or its fixed technology expenditure (FTE) for a period of 13 weeks in case of OEBR and 12 months in case of FTER or a period as determined by the Commission from time to time. **In determining OEBR or FEBR or FTER**, the following principles are applied:

(i) Armotisation, Depreciation and profits or losses on sales of fixed assets are non-cash items and hence should not be taken into account;

(ii) Non-contractual payments by way of profit shares or performance related bonuses should be excluded; and

(iii) Exceptional or extra-ordinary items may be excluded, subject to the approval of the Commission;

"Operational risk" means risk of loss arising from inadequate information systems and technology failures, internal control breaches, fraud and unforeseen catastrophes;

"Position risk" refers to loss in earnings due to loss from on and off SMIs balance sheet positions (proprietary) arising from adverse movements in the market prices such as interest rates, equity prices and foreign exchange rates;

"Securities Market Intermediaries" means persons licensed and registered in terms of Section 38 of Securities and Exchange Act, [Chapter 24:25], Asset Management Act [Chapter 24:26 and the Collective Investment Schemes Act [Chapter 24:19];

3. Determination of Capital requirements for SMIs

These capital requirements may not fully cover SMIs against significant fraud or other risks, which are not reasonably predictable. Additional capital or any other arrangements or risk mitigation strategies shall be required of SMIs to the extent that their business operations expose them to levels of risk in excess of that covered by capital requirements stipulated in these regulations. The additional levels of capital shall be determined by the Commission at amounts, which are designed to protect the investing public and other SMIs from loss as a result of failure of the affected SMI.

3.1. The SMI shall calculate its overall capital requirements in accordance with the table 1 as follows:

Table 1

Requirements		**$$**
Operational expenditure/Fixed Expenditure Base Requirement (13 weeks) OR Fixed Technology Expenditure Requirement (FTER) (annual)	a	xx
Counterparty Risk Requirement (CRR): **Table 2**		
Position risk requirement (PRR): **Table 3**	b	
Settlement Risk Requirement (SRR)	c	
Other risks	d	xx
Total Requirement (TR) (a+b+c+d)		**xx**
Adjusted Liquid Capital (ALC): **Table 4**		xx
Capital Surplus/(shortfall)	**ALC** less **TR**	**xx/(xx)**

3.1.1. Counterparty Risk Requirement

i. SMIs shall calculate total CRR on counterparty exposures irrespective of any connection with any counterparty arising from their business in table 2 as follows:

Table 2

Type of transaction	Risk factor	CRR Value
Unsettled securities transactions traded on securities exchange in Zimbabwe, Government, Quasi Government and Corporate bonds:		
0 to 30 days after settlement date	50% of potential loss	xx
More than 30 days after settlement date	100% of potential loss	xx
Amounts due for payment or owned on closed positions 7 days due and above	100% of amount unsecured	xx
Other receivables outstanding for more than 30 days:		
Commissions and fees earned	100% of potential loss	xx
Marketable securities at maturity date or call	100% of potential loss	xx
Scrip issues and rights issues	100% of potential loss	xx
Any other receivables	100% of potential loss	xx
Total to Table 1		xx

ii. The SMI shall reduce the exposure if it has made provision for a specific counterparty balance or it holds security against the specific counterparty.

iii. SMI may use its own methods and procedures in arriving at amount of potential loss. Acceptable evidence which may be used by SMI includes but not limited to confirmation of the transactions, financial standing or soundness; presence and adequacy of security and or provision of acceptable guarantees.

3.1.2. Position Risk Requirement:

i. SMIs shall calculate its risk exposures on positions it holds from different classes of securities as shown table 3 as follows:

Table 3:

	Market Value	Risk Factor	PRR
Listed shares on securities exchange	x	40%	xx
Debt securities			
Issued or Guaranteed by Government	x	0%	xx
Issued or accepted by Bank	x	40%	xx
Corporate and other listed debt securities	x	40%	xx
	Total to table 1		**Xx**

ii. For the purpose of calculating PRR, shares, bonds and financial instruments positions shall be marked to market;

3.1.3. Adjusted Liquid Capital (ALC):

The SMI shall calculate its ALC in accordance with the table 4 below as follows:

Table 4

Ordinary share capital	Xx
Preference share capital	xx
Share premium account	xx
Audited retained earnings or accumulated losses	xx
Unaudited profit or loss	xx
Owners Equity	**XX**
+Shareholders' loans	xx
+Guarantees received	xx
Total Capital Resources (a)	**XX**
Less Intangible assets +Guarantees provided (b)	**XX**
Goodwill	xx
Capitalised development costs	xx
Licensees, software's	xx
Trademarks and similar rights	xx
Guarantees provided	xx
Available capital resources (c)= (a-b)	**XX**
Less Illiquid Assets (d)	**XX**
Fixed assets, net of related secured loans	xx
Investments in unlisted securities	xx
Adjusted Liquid Capital (c-d)	**Xxx**

i. Audited retained earnings shall be subject to an independent auditor's unqualified report;

ii. Fixed assets shall be net of related secured loans, where such fixed assets are used as security for loans, the amount to be deducted may be reduced to the extent of the secured loan outstanding.

3.1.4. Settlement Risk Requirement (SRR)

iii. SMIs namely the Custodians, CSD and to lesser extent Securities Dealing (Stockbroking) firms may have settling arrangements with clearing banks for the purpose of settling securities transactions on the securities exchanges. In terms of this directive: Custodians, CSD and Brokers shall ensure that their appointed Clearing Banks maintain a minimum collateral deposit as determined from time to time by the Reserve Bank of Zimbabwe in their collateral sub-account at Reserve Bank of Zimbabwe, specifically to cover securities settlement obligations on a normal trading day. The collateral amount for each Clearing Bank shall be recalculated at the end of each month depending on the Clearing Bank's exposure to the market based on the set formula by RBZ and CSD;

iv. In principle, collateral should be adequate to cover the highest exposures by Depository Participants that has been observed in the market. Therefore a Clearing Bank cannot withdraw from their collateral sub-account even when the previous month's collateral calculation falls below the subsequent month's calculation;

v. Until otherwise notified, in writing by CSD the collateral security must be in the form of cash and deposited into a Clearing Bank's collateral sub-account maintained with the Reserve Bank of Zimbabwe;

vi. CSD shall monitor the exposures of Depository Participants and Clearing Banks on an on-going basis. Should a particular Clearing Bank's exposure get close to or reach the level of the collateral lodged, CSD will immediately request the Clearing Bank to top up the collateral by an agreed amount within 48 hours.

vii. In the event the Clearing Bank fails to meet the top-up request, CSD reserves the right to immediately disconnect the relevant Depository Participants from the CSD System.

3.1.5. Other risks requirement

i. The SMI shall also be required to provide for net exposures (risks) arising from any other risks applicable to the nature of its business activities

4. Capital requirements for SMIs

The capital adequacy requirements of SMIs shall be determined from time to time by the Commission in consultation with the SMIs, and shall be based on the operational costs of the SMIs, the required capital expenditure and the risk taken by the SMIs.

4.1. Securities Dealing (Stock-broking) firms

Securities dealing firms shall be required to maintain:

(a) Tier 1 Capital, namely liquid capital equivalent to-

i. the company's operational costs (OEBR) over a minimum of thirteen weeks; or

ii. Seventy five thousand United States Dollars whichever is the higher, placed with at least two independent financial institutions; and

(b) Tier 2 Capital, determined by the risk to which the company exposes itself through the nature of its business. In computations of the capital under Tier 2, SMI shall be guided by section 3 of this directive. SMI shall also be required to have adequate and relevant risk covers, namely (i) Professional indemnity cover and (ii) Fidelity Guarantee cover, and any necessary insurance covers taken to support and strengthen its risk management strategy; and

(c) Tier 3 Capital:

i. which shall be Adjusted Liquid Capital (ACL) which must always be greater or sufficient to meet its 13 Weeks operational expenditure or Seventy five thousand United States Dollars and SMI's risk requirements provisions applicable to securities dealing firms business activities, that is, ALC shall be greater than the aggregate of Tier 1 and Tier 2; and

ii. maintain all times, current assets which are greater than current liabilities and healthy cash to working capital position; and

4.2. Securities (Brokers) dealers trading on his or her own account

Third Schedule (Rule 23), section 2 provides for requirements for obtaining securities dealers licence authorizing the holder to carry on business as a dealer on his or her own account. Sixth Schedule, Section 5 further provides capital requirements for the securities dealer and section is now amended as follows:-

i. the capital requirement of a securities dealer shall be liquid assets of ten thousand United States Dollars or an equivalent amount in other currencies acceptable in Zimbabwe placed with any registered financial institution in Zimbabwe; and
ii. The securities dealer shall have net worth of more than ten thousand United States Dollars or equivalent currencies acceptable in Zimbabwe; and
iii. The securities dealer shall have a professional indemnity and fidelity guarantee covers from the date on which he or she commences operations; and
iv. The securities dealer shall make necessary arrangements with persons and or institutions that shall provide on his or her behalf: clearing, settlement and IT facilities, compliance, and administrative functions which may include his or her official office.

4.3. Securities investment (Asset/Fund) management firms

Securities investment managers shall be required to maintain:-

(a) Tier 1 Capital, namely liquid capital equivalent to -

i. the company's operational costs (OEBR) over a minimum of thirteen weeks; or
ii. One hundred and fifty thousand United States Dollars or an equivalent amount in other currencies acceptable in Zimbabwe; whichever is the higher, placed with at least two independent financial institutions; and

(b) Tier 2 Capital, determined by the risk to which the company exposes itself through the nature of its business. In computations of the capital under this tier, the investments manager shall be guided by section 3 of this directive. The investments manager shall also be required to have adequate and relevant risk covers, namely (i) Professional indemnity cover and (ii) Fidelity Guarantee cover, and any necessary insurance covers taken to support and strengthen its risk management strategy; and

(c) Tier 3 Capital:

i. which shall be Adjusted Liquid Capital (ACL) which must always be greater or sufficient to meet its 13 Weeks operational expenditure or one hundred and fifty thousand United States Dollars and investment's risk requirements provisions applicable to the investment manager's business activities, that is, ALC shall be greater than the aggregate of Tier 1 and Tier 2; and

ii. maintain all times, current assets which are greater than current liabilities and healthy cash to working capital position; and

4.4. Securities investment advisory firms

The securities investment advisory firms shall be required to maintain:-

(a) At all times, positive and sufficient shareholders funds to meet its day to day expenditure, future obligations and risk taken by the firm; and

(b) At all times, current assets which are greater than current liabilities and healthy cash to working capital position; and

(c) Professional indemnity cover with the following minimum stipulations:

(i) Corporate finance advisory services	US$ 15 000
(ii) Investment products advisory services	US$ 15 000
(iii) Corporate finance + Investment products advisory	US$ 20 000;

4.5. Securities trustees firms

Securities trustees shall be required to maintain:-

(a) At all times, minimum adjusted liquid capital (ALC) of US$500 000 sufficient to meet its day to day expenditure, default and any other risk requirements; and

(b) At all times, current assets which are greater than current liabilities and healthy cash to working capital position. The Licensee must be compliant with

RBZ prescribed minimum liquidity ratio(s) for licensees who are affiliated to banks. Trustees not aligned to banks shall be required to maintain similar minimum liquidity ratios as prescribed to licensees affiliated to banks or as prescribed by their regulators; and

(c) Satisfactory capital rating by Reserve Bank of Zimbabwe for licensees affiliated to banks or as prescribed by their regulators; and

(d) Insurance covers with the following minimum stipulations for;

(i) Professional indemnity	US$300 000
(ii) Fidelity Guarantee Cover	US$100 000

4.6. Securities Custodial firms

Custodial firms shall be required to maintain:

(a) At all times, minimum adjusted liquid capital of US$500 000 sufficient to meet its day to day expenditure, default and any other risk requirements; and

(b) At all times, current assets which are greater than current liabilities and healthy cash to working capital position. The Licensee must be compliant with RBZ prescribed minimum liquidity ratio(s) for licensees belonging or affiliated to banks. Non-banking related licensees shall be required to maintain similar minimum liquidity ratios as prescribed to licensees related to banks or as prescribed by their regulators; and

(c) At all times, through their appointed clearing banks maintain a minimum collateral deposit as determined from time to time by the Reserve Bank of Zimbabwe in their collateral sub-account at Reserve Bank of Zimbabwe, specifically to cover securities settlement obligations on a normal trading day. The collateral amount for each Clearing Bank shall be recalculated at the end of each month depending on the Clearing Bank's exposure to the market based on the set formula by RBZ and CSD; and

(d) Satisfactory capital rating by Reserve Bank of Zimbabwe for banks holding Custodial Licenses; and

(e) At all times, insurance covers with the following minimum stipulations for;

(i) Professional indemnity	US$300 000
(ii) Fidelity Guarantee Cover	US$100 000

Securities Transfer Secretaries

Securities transfer secretaries shall be required to maintain:

(a) adjusted liquid capital of US$150 000 sufficient to meet its day to day expenditure, future obligations, default and any other risk requirements; and

(b) current assets which are greater than current liabilities and healthy cash to working capital position; and

(c) insurance covers with the following minimum stipulations for;

(i) Professional indemnity US$150 000

(ii) Fidelity Guarantee Cover as per firm's risk requirements; and

4.7. Securities Exchanges

Securities exchanges shall be required to maintain:

(a) Tier 1 Capital, namely liquid capital equivalent to-

i. liquid capital sufficient to meet its annual operating expenditure related to software licensees, upgrades and maintenance/Fixed Technology Expenditure Requirements (FTER); and

ii. Liquid capital sufficient to meets its operational costs excluding FTER over a minimum thirteen weeks

(b) Tier 2 Capital, determined by the risk to which the company exposes itself through the nature of its business. In computations of the capital under this tier, the securities exchange shall be guided by section 3 of this directive. The securities exchange shall also be required to have adequate and relevant insurance covers taken to support and strengthen its risk management strategy; and

(c) Tier 3 Capital:

i. which shall be Adjusted Liquid Capital (ACL) which must always be greater or sufficient to meet its annual FTER requirements; operational expenditure (OEBR); and investment's risk requirements provisions applicable to the investment manager's business activities, that is, ALC shall be greater than the aggregate of Tier 1 and Tier 2;

ii. Maintain net assets of one million United States Dollars; and

iii. maintain all times, current assets which are greater than current liabilities and healthy cash to working capital position; and

4.8. Central Securities Depository (CSD)

CSD shall be required to maintain at all times:

(a) Tier 1 Capital, namely liquid capital equivalent to-

i. liquid capital sufficient to meet its annual operating expenditure related to software licensees, upgrades and maintenance/Fixed Technology Expenditure Requirements (FTER); and

ii. Liquid capital sufficient to meets its operational costs excluding FTER over a minimum thirteen weeks; and

(b) Tier 2 Capital, determined by the risk to which the company exposes itself through the nature of its business. In computations of the capital under this tier, the central securities depository shall be guided by section 3 of this directive. The central securities depository shall also be required to have adequate and relevant insurance covers taken to support and strengthen its risk management strategy; and

(c) Tier 3 Capital:

i. which shall be Adjusted Liquid Capital (ACL) which must always be greater or sufficient to meet its annual FTER requirements; operational expenditure (OEBR); and investment's risk requirements provisions applicable to the securities exchange's business activities, that is, ALC shall be greater than the aggregate of Tier 1 and Tier 2; and

ii. maintain net assets of one million United States Dollars; and

iii. maintain all times, current assets which are greater than current liabilities and healthy cash to working capital position.

5. General Obligations

5.1. SMIs shall submit returns to the Commission in the form set out in section 3.1.5 of this directive by the tenth business day of each quarterly period, reflecting the SMIs risk positions; adjusted liquid capital and capital surplus or shortfall;

5.2. The SMI shall notify the Commission immediately in writing if there are indication that it may not meet its capital requirements;

5.3. The Commission may appoint an external auditor or any other competent persons at SMI's cost, to verify SMI's capital shortfalls when they are detected or suspected;

5.4. The Commission has full discretion as to the necessity and sufficiency of special adjustments in any particular case, taking into consideration all factors pertaining to the market with regard to financial position or future contracts and the affairs as a whole of the SMI involved;

5.5. Where the SMI fails to comply with this directive, the Commission shall have the power, in terms of the Securities and Exchange Act, to reprimand, sanction, suspend and or cancel the licence of the SMI;

5.6. SMI shall send together with its audited financial statements, capital adequacy certificate from its auditors;

5.7. The liquid capital shall not be withdrawn or liquidated without the approval of the Commission. However, it can roll over or move to different financial institutions from time to time;

5.8. Liquid capital shall be placed with at least two independent financial institutions of the SMI's choice;

5.9. Insurance policies shall be in such reasonable form and amount as the fiduciary duties of the employees or sponsored individuals require but with due consideration to all relevant factors in relation to all relevant factors in relation to all its licensed activities. The policy shall be renewed annually not later than each anniversary of the commencement of the policy. The policy shall be issued by an insurer registered in terms of the Insurance Act [Chapter 24:07] or an equivalent Act for SMIs who are part of an international group or with foreign operations.

5.10. Returns submitted by the SMIs shall be signed by the Principal Officers;

5.11. Review of capital adequacy requirements for SMIs shall be done on an annual basis.

For and On Behalf of Securities and Exchange Commission of Zimbabwe

Mr. Tafadzwa Chinamo
Chief Executive Officer

Date: 11/07/17