The View From Cape Town by Charles Gubert

The Network Forum kicked off its 2018 global tour with the Africa Meeting taking place in the shadow of Table Mountain in Cape Town. Attended by more than 130 delegates drawn not just from the continent but across Europe, Asia and North America, the conference touched upon a number of burning issues currently impacting African securities markets.

The Market Recovers….slightly

While there is a renewed sense of optimism in South Africa, its recovery remains fragile. Relative to the rest of Sub-Saharan Africa (SSA), South Africa's GDP (gross domestic product) growth continues to be under par. The International Monetary Fund (IMF) anticipates the country's GDP will grow by just 1.1% in 2018 versus the regional average of 3.8%.

Only two other countries in the region had lower growth forecasts, namely Zimbabwe and Equatorial Guinea. South Africa's GDP growth is mainly off the back of an improving business climate which is fuelling investment; a gradual recovery from a destabilising drought; a normalisation of commodity prices; and a change in political leadership.

Elsewhere in Africa, Nigeria is going through a recovery, having seen an improvement in oil prices. The return to health of the continent's two biggest economic powerhouses, which collectively comprise more than 50% of SSA's GDP, is a much welcome respite for some of the other smaller countries in the region.

The Network Manager Perspective

Asset safety is top of mind at network managers. With UCITS V and AIFMD firmly bedded down and the liability risk fully digested, the role of the network manager has assumed greater significance. Emerging or frontier markets naturally tend to pose a higher asset safety risk, mainly because some of the local counterparties have lower credit ratings.

Equally, local legislation governing insolvencies or asset safekeeping provisions are often more immature in certain African jurisdictions. In markets where risk management standards or local providers fall well below international expectations, banks will not hesitate to withdraw business if necessary.

The DDQ

The AFME (Association for Financial Markets in Europe) Due Diligence Questionnaire (DDQ) has divided the industry. The concept of standardisation is hard to criticise, and the DDQ's original purpose to streamline network manager due diligence was welcomed initially by custodians/broker-dealers and sub-custodians.

Network managers have since incorporated additional questions into the DDQ template, which some believe has undermined AFME's harmonisation efforts. The volume of extra, bespoke questions now being asked in DDQs has prompted some sub-custodians to moot whether they should start charging clients for filling in the templates.

The response from the network managers to this suggestion has been fairly uncompromising, pointing out that the sub-custodian market is rife with choice, and that any attempt to levy charges on the DDQ compilation process could result in clients switching service providers.

Attracting liquidity

With most African markets having electronic trading and settlement, the absence of liquidity in a number of jurisdictions is clearly nothing to do with the state of the continent's infrastructure. The local institutional investor base is maturing as pension fund industry assets continue to grow, driven by government efforts to encourage people to save.

However, local pensions typically buy and hold securities for a long time, thereby stifling liquidity. This is partly because there is a limited number of viable listed securities to purchase, leading some markets to initiate efforts to internationalise their stock exchanges, and encourage foreign listings.

Mauritius, for example, has eased its listing rules and pushed ahead with double taxation treaties prompting a number of global fund managers to list on its exchange. Other schemes to attract liquidity to the region include the establishment of cross-border stock exchange linkages, modelled on the highly successful Stock Connect in China.

Disruption in Africa

Network managers have repeatedly implored frontier economies to build market infrastructures such as CSDs and CCPs, arguing that their continued absence in African countries is a blocker to meaningful investor flows. In a world of Blockchain and DLT, this infrastructure deficiency is now viewed as being an advantage.

Developed markets have been slow to adopt Blockchain, mainly because integrating the technology into legacy systems like COBOL is profoundly difficult and complex. Frontier markets do not have that problem. Blockchain's applicability in areas like reconciliation; clearing and settlement are well known, but some believe it is the ICO or initial coin offering which could have a major impact in Africa.

IPOs in Africa have been far and few between, but an ICO – which is means for issuers to raise capital from ordinary investors on a Blockchain and in the form of cryptocurrencies – could redefine African securities markets. In a region as tech-savvy as Africa, ICOs could become popular channels for investment among retail allocators.

This would give SME businesses easier access to funding and capital markets, and would provide a massive liquidity boost in the region. Unfortunately, ICOs are fraught with legal risk as they are not regulated under securities laws, putting investors at risk of suffering serious losses should the issuance turn out to be fraudulent. ICOs – once properly regulated however – could dramatically alter equity markets as we know it.

Cyber-security

Cyber-security is a global problem and it is a particularly potent risk in emerging and frontier markets where local providers and suppliers occasionally do not subscribe to international standards around cyber-security. Simultaneously, regulation and laws against cyber-crime may be quite basic or not even exist in some markets.

For banks with exposures to local providers, the threat of cyber-crime is a very real one. Sixty-one percent of TNF attendees confirmed that cyber-risk was an increasing focal point in their counterparty risk assessments. Concerted efforts have been made to instil awareness about cyber-security, with 70 percent of TNF delegates stating cyber-training had been effective at their organisations.

TNF Looking Ahead

TNF's Annual Meeting will take place in Vienna between June 25 and 27, 2018, and this will be followed later in the year with further meetings in New York and Singapore.