

CLARIFICATION NOTE CN000(3)

ON

CODE SERIES FS000, STATEMENT 000

GENERAL PRINCIPLES AND THE SCORECARD

Guidelines: Equity Equivalents Programme for Multinationals in the Financial Sector

1. Introduction

The Financial Sector Code requires that all entities operating in the South African economy make a contribution towards the objectives of Broad-Based Black Economic Empowerment (B-BBEE). It is, however, acknowledged that there may be Multinationals that have global practices preventing them from complying with the ownership element of B-BBEE through the traditional sale of shares to black South Africans. In this instance, and provided that it can be proven that such entities do not enter into any partnership arrangements in other countries globally, the Financial Sector Code has made provision for the recognition of contributions in lieu of a direct sale of equity. Such contributions are referred to as Equity Equivalent (EE) contributions. Such EE contributions count towards the ownership element of B-BBEE made by Multinationals. The value of these EE contributions should be measured against 25% of the value of the Multinational's South African operations.

Equity Equivalent would entail a public programme/scheme and/or private programme/scheme designed to fulfil the requirements of B-BBEE ownership. Equity Equivalent may also entail a programme targeting investment or any other programme that promotes Socio-Economic advancement/development within the South African Economy. Such a programme needs to be approved by the Minister of Trade and Industry in order to qualify for ownership points on the scorecard. Where approval for an EE Programme

has been granted, the programme and points awarded may not form part of any other B-BBEE element in the Multinational's B-BBEE Scorecard.

2. Objectives of Equity Equivalent Programmes

- a Enterprise creation and initiatives that support Enterprise Development as per Codes 600, Statement 600.
- b Foreign direct investment by the Multinational into the EE Programme
- c Accelerate the empowerment of black rural women, youth and communities.
- d Sustainable growth and development.
- e Human resource development with a focus on education and skills development.
- f Infrastructure investment with an emphasis on developing the country's research and development infrastructure.
- g Economic programmes, which give effect to the objectives of the National Industrial Policy Framework.
- h Economic programmes which give effect to the objectives of any other Government initiatives as identified by **the dti** and the relevant line ministries.
- i Initiatives that support Socio-Economic Development Programmes as per Code 700, Statement 700.

3. Principles

- a The economic impact of the EE programme must be aligned to the objectives of the B-BBEE Act.
- b The EE programme must not displace other B-BBEE initiatives to be undertaken as per the scorecard.
- c The EE programme must be broad based in its impact on the black population and the South African economy.

- d The Multinational must illustrate causality of the EE programme, i.e., that the EE programme was the basis for the Multinational to comply with the Equity Equivalent Statement, Statement 103, of FS100.

4. Qualification Criteria for the Equity Equivalent

- a EE proposals must demonstrate commercial liability and long-term sustainability (economically and operationally).
- b EE proposals must be aligned to the overall objectives of B-BBEE.
- c There must be a transfer of accredited business and/or technical skills
- d EE proposals must be measurable against the value of their operations locally with tangible measurable outputs.
- e EE proposals must demonstrate the benefit accruing to the South African economy beyond the core business activities of the Multinational.

5. Recommended Forms of Equity Equivalent

- a Programmes outlined on paragraph 3.4 of FS100, Statement 103
- b Programmes aligned to FS600, Empowerment Financing
- c Programmes aligned to FS700, Access to Financial Services
- d Economic Development Programmes
- e Projects aimed at technology transfer/diffusion within the small, medium and micro-enterprise sector of the local economy beyond the Multinational's core business activities
- f Programmes that promote economic growth and employment creation through the development of technological innovation beyond the Multinational's core business activities
- g Initiatives that must lead to sustainable job creation

6. The Role and Responsibilities of EE Programme Candidates

- a To carry out EE programme in line with B-BBEE objectives

- b** To target sustainable projects that are in line with Government's accelerated growth initiatives.
- c** To submit all documents two weeks prior to the scheduled EE Committee meetings.
- d** To provide a Valuation Report demonstrating the assumptions made and the viability of the valuation.
- e** To submit EE proposals, which are measurable against the value of their local operations, with tangible measurable outputs.
- f** To enter into a Memorandum of Agreement (MOA) with **the dti** regarding the EE Programme prior to approval of the EE programme and prior to the awarding of points under the Ownership Scorecard.
- g** To submit Monitoring and Evaluation Reports to **the dti**, as per the above-mentioned MOA and published Monitoring and Evaluation Guidelines.

7. The Role and Responsibilities of the Equity Equivalent Committee

- a** Evaluate and negotiate EE proposals against the set criteria
- b** Provide recommendations to the Minister on the approval/rejection of an EE Programme
- c** Monitor and evaluate the implementation of EE Programmes
- d** Provide strategic direction on B-BBEE and approve EE proposals
- e** Liaise and disseminate information regarding EE to other Government departments and stakeholders
- f** The EE Committee to convene on a monthly basis

8. Composition of the Equity Equivalent Committee

8.1 Permanent members of the EE Committee

- a Broad-Based Black Economic Empowerment Unit within **the dti**
- b National Industrial Participation Secretariat Unit within **the dti**
- c Industrial Development Corporation

8.2 Adhoc members of the EE Committee

- a Any other relevant division within **the dti**, e.g., ERPC, SMME, CSP
- b Sector Representative
- c Line Ministry Representative
- d Adhoc members are invited to participate in the EE Committee if deemed necessary for the evaluation of an EE programme within their area of expertise.

9. Procedure for the Approval of EE Participation

Phase 1

- a Multinational entity submits an application to **the dti** for exemption from sale of equity.
- b Multinational must prove that such sale of equity is against their global practice.
- c **the dti** to grant exemption from selling equity and participation in an EE Programme.
- d Multinational obtains in principle support for the EE Business Plan from the relevant line Ministry. A letter from the line ministry to be included in application of Phase I.

Phase 2

- a Multinational to submit EE proposal and Valuation Report to **the dti** within 60 days from the date of receiving exemption.
- b Evaluation of EE proposal and Valuation Report by the EE Committee.

- c Granting of pre-approval by **the dti**, within two weeks from date of evaluation.
- d In the event of pre-approval of the EE proposal, finalization of the MOA must be concluded prior to final approval and awarding of points.
- e In the event that the proposal is rejected, **the dti** to notify the Multinational in writing substantiating the reasons for rejection.
- f The EE committee to make recommendations to the Minister for final approval.
- g Ownership Scorecard points for EE to be awarded according to the 25% value of the South African operations as agreed, for the duration of the measurement period.

NB: IT MUST BE NOTED THAT PRO-RATA POINT ALLOCATION IS NOT APPLICABLE TO THE EQUITY EQUIVALENT STATEMENT, STATEMENT 103 OF THE B-BBEE CODES OF GOOD PRACTICE.

DETAILS: PHASE 1

Step 1: Application for Exemption

- a There is a standard form which can be obtained from **the dti's** B-BBEE Unit, which spells out the documents required.
- b To ensure the processing of the proposal for EE an application letter is required covering the following areas:
 - i. That the Multinational is applying for exemption from selling equity and would like to participate in an EE Programme.
 - ii. State the reasons for being unable to sell equity in South Africa.
 - iii. Disclose a list of countries in which the Multinational operates.
 - iv. Disclose the number of entities within each country where the Multinational operates.
 - v. Disclose all countries where equity was sold.

- vi. Where equity was sold, provide motivation as to the circumstances that formed the decision to sell. (If local legislation applies specify the act)
- vii. Provide ownership details where the Multinational owns less than 100%
- viii. Illustrate the size (value) of the South African operations against that of the holding company and compare to any other operations where the Multinational may have sold equity
- ix. Give an indication as to the type of EE programme under consideration
- x. Provide an independent audit verifying the Multinational's assertion of having or not having sold equity in any of their global operations stating clearly countries where equity has been sold (if applicable).

NOTE A:

IT MUST BE NOTED MULTI-NATIONALS HAVE MULTIPLE OPERATIONS IN MANY COUNTRIES AND THE TASK OF AUDITING THESE ENTITIES WOULD BE TEDIOUS, TIME CONSUMING AND EXPENSIVE.

THE DTI CONCEDES THAT AN EXTERNAL AUDIT IS REQUIRED. HOWEVER, THE AUDITOR COULD RANDOMLY SELECT ANY 20 COMPANIES TO CONFIRM THAT NO EQUITY WAS SOLD OVER THE LAST TEN YEARS.

IN THE EVENT THAT EQUITY WAS SOLD, THE CIRCUMSTANCES AROUND THE SALE WOULD BE INCLUDED. HOWEVER, THE RISK OF THE RANDOM SELECTION LIES WITH THE ENTITY LOSING THEIR EXEMPTION CERTIFICATE SHOULD IT BE FOUND THAT EQUITY WAS SOLD IN OTHER COUNTRIES AND THAT THIS INFORMATION WAS NOT DISCLOSED IN THE APPLICATION.

- c **the dti** is required to present a sound case to the Committee that it is global practice for the Multinational not to sell equity. A list of the Multinational's business interests in other countries and the extent of

these are required. These may need to be supported by the independent auditors and annual financial statements/reports.

- d EE Committee to decide on whether an exemption applies or not and make recommendations to the Deputy-Director General: EDD for approval or rejection of Phase One.

NOTE B:

THE DTI'S DECISION WOULD BE TAKEN AT THE MONTHLY EEIP COMMITTEE MEETING WHICH APPLICANTS NEED TO ATTEND, AND ANOTHER WEEK WOULD BE REQUIRED TO HANDLE ADMINISTRATION. IF REQUIRED, ALLOWANCE CAN BE MADE FOR A SPECIAL MEETING DURING A MONTH.

DETAILS: PHASE 2

**Step 2: Submission of the Proposed Contribution Amount - the Valuation Report
(for the utilization of the 25% value)**

- a The Multinational would be required to undertake a financial valuation (which also needs to be verified by independent auditors) to determine the EE contributions, as per the minimum criteria set forth below.
- b A standard valuation method must be undertaken (the Discounted Cash Flow Valuation Methodology is preferred) and the Multinational may make a presentation to the EE Committee, if so required, once the Report has been submitted for review.
- c Signed audited financials for the last 3 years including the income statement and balance sheets.
- d **2 year** Balance sheet and income statement forecasts. The income statement and balance sheet figures must have at least the detail of the audit financials so that they are comparable.

- e The latest management accounts which must have at least the detail of the audit financials so that they are comparable.
- f The company should present an independent third-party standard valuation, preferably the discounted cash flow valuation, of the local business entity performed by an independent non-connected third party with a clear motivation for reasonability and should be based on a due diligence of the local business entity.
- g Economic assumptions underlying forecasts inter alia, exchange rates, inflation rates, stock/debtor/creditor days.

For the avoidance of doubt, the EE Committee shall be reviewing the company's financial information and independent valuation report and comment on reasonability and will not be performing a due diligence.

Step 3: Evaluation of EE proposals

- a Once exemption has been granted, the Multinational would be required to submit, to **the dti**, a detailed business plan of the EE programme (as per the business plan template provided) and linked to the EE contributions as per valuation.
- b It must be noted that agreement on the valuation must be reached prior to any approval of the proposal.
- c The EE committee will assess proposals submitted within 60 days of receipt of exemption and at least 2 weeks prior to the scheduled EE committee meeting
- d MOA negotiated and signed prior to making recommendations to the Minister.

Step 4: Points under the Scorecard are granted

- a Use of the EE points under ownership is subject to a Memorandum of Agreement (MOA) between the EE applicant and **the dti**.

- b** Once approval by the Minister of Trade and Industry, for the EE Contribution and the EE Programme, has been granted and the MOA has been signed, points under the ownership element may be awarded to the Multinational.

DETAILS: PHASE 3

Step 5: Monitoring of EE Projects against original EE proposal

- a** The Multinational is to report back on the progress of the EE Project as per the EE proposal, MOA and Monitoring and Evaluation by **the dti**.

The EE Committee is scheduled to meet on a monthly basis. The EE Secretariat within the BEE Unit is the point of entry for EE applications and for further information.