



REPABOLIKI YA AFERIKA BORWA

REPUBLIC VAN SUID AFRIKA

BROAD-BASED BLACK ECONOMIC EMPOWERMENT ACT

Section 9(5): Codes of Good Practice

It is hereby notified that the Minister of Trade and Industry hereby issues the following draft Code of Good Practice for public comments under section 9(3) of the Broad-Based Black Economic Empowerment Act 53 of 2003. Interested persons are invited to furnish the Minister with comments on this proposed code within 60 days of the date of publication.

**CODE 000: FRAMEWORK FOR THE MEASUREMENT OF BROAD BASED BLACK
ECONOMIC EMPOWERMENT**

**STATEMENT 001: FRONTING PRACTICES AND OTHER MISREPRESENTATION OF BEE
STATUS**

Issued under section 9(5) of the Broad-Based Black Economic Empowerment Act 53 of 2003 for public comment. Interested persons are invited to furnish the minister with comments on this proposed code within 60 days of the date of publication.

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1 DEFINITIONS

In this statement, unless the context otherwise indicates, a word or expression to which a meaning has been assigned in the Act bears the same meaning, and:

- 1.1 **"Affected Decision Makers"** means individuals who are tasked with making economic decisions on behalf of an organ of state, a public entity or an Enterprise, where the economic decisions involve the consideration of an Enterprise's BEE Status;
- 1.2 **"BEE Status"** means the compliance bands referred to in Code 000 Statement 000 and in Code 1000 Statement 1000;
- 1.3 **"BEE"** means black economic empowerment;

- 1.4 "**black people**" bears the same meaning as defined in Code 000 Statement 000;
- 1.5 "**Companies Act**" means the Companies Act of 1973;
- 1.6 "**Enterprise**" bears the same meaning as defined in Code 100 Statement 100;
- 1.7 "**Excessive Rate**" means a rate of interest charged on any loan advanced to an Enterprise by a Related Person which exceeds the rate of interest which the Related Person would ordinarily receive in respect of any equivalent loan from its bankers by a percentage which is in excess of half of the difference between that rate of interest and the Maximum Rate;
- 1.8 "**Fronting Risk Indicators**" means the list of risk indicators identified in paragraph 7 and which are considered to be indicative of the presence of Fronting practices;
- 1.9 "**Fronting**" means any practices or initiatives which are in contravention of or against the spirit of any law, provision, rule, procedure, process, system, policy, practice, directive, order or any other term or condition pertaining to black economic empowerment under the Codes;
- 1.10 "**holding company**" shall be interpreted *mutatis mutandis* by reference to the definition provided in section 1(4) of the Companies Act;
- 1.11 "**Maximum Rate**" means the rate specified in respect of the maximum annual finance charge rate as determined in terms of section 1(a) of the Usury Act of 1968. To the extent that regulations under section 1(a) of the Usury Act of 1968 specify different maximum rates of annual finance charge rate against various lending thresholds, the rate in respect of the upper most threshold shall apply;
- 1.12 "**Related Person**" of a measured Enterprise means another person:
- 1.12.1 which is directly or indirectly controlled by a measured Enterprise;
- 1.12.2 which is directly or indirectly controlled by the natural persons who have direct or indirect control over that measured Enterprise or the immediate family of those natural persons; and
- 1.12.3 over whom the measured Enterprise has direct or indirect control;
- 1.13 "**subsidiary**" shall be interpreted *mutatis mutandis* by reference to the definition provided in section 1(3) of the Companies Act;

- 1.14 **"Transfer Pricing"** means transactions where goods and/or services are supplied to or acquired from a Related Person by an Enterprise where the goods and/or services are supplied at a significantly higher or lower rates than the market rate for such goods and/or services;
- 1.15 **"Verification Agency"** means a BEE Verification Agency duly accredited in terms of Code 000, Statement 020; and
- 1.16 **"Verification Certificate"** means a BEE certificate issued by a Verification Agency in compliance with the Codes.

2 INTERPRETATION OF THIS STATEMENT

- 2.1 When interpreting a provision of this statement, any reasonable interpretation which is consistent with the objectives of the Act must be preferred over any other interpretation which is inconsistent with such objectives.
- 2.2 To the extent that any provision of this statement is inconsistent with the Act, the Act shall prevail.

3 APPLICATION OF THIS STATEMENT

This statement applies to all Enterprises subject to the Codes.

4 OBJECTIVE OF THIS STATEMENT

The objectives of this statement are as follows:

- 4.1 to specify Fronting practices;
- 4.2 to identify the indicators of Fronting Risk;
- 4.3 to specify the requirements for reporting of Fronting practices;
- 4.4 to define the guidelines for determination and evaluation of Fronting Risk; and
- 4.5 specify the consequences of Fronting practices.

5 GENERAL PRINCIPLE

- 5.1 In evaluating any Enterprise for any purposes contemplated in the Act or the Codes, Verification Agencies and Affected Decision Makers are expected to apply all reasonable efforts to identify Fronting practices and, in so doing, must ensure that substance must always take precedence over legal form.

- 5.2 Notwithstanding the foregoing, nothing in this statement should be construed as requiring Verifications Agencies or Affected Decision Makers violate the constitutional rights of any person.

6 FRONTING PRACTICES

Fronting practices include, but are not limited to:

- 6.1 **Window-dressing:** This includes cases in which black people are appointed or introduced to an Enterprise on the basis of tokenism and may be:
- 6.1.1 discouraged or inhibited from substantially participating in the core activities of an Enterprise; and
 - 6.1.2 discouraged or inhibited from substantially participating in the stated areas and/or levels of their participation;
- 6.2 **Benefit Diversion:** This includes initiatives implemented where the economic benefits received as a result of the BEE Status of an Enterprise do not flow to black people in the ratio as specified in the relevant legal documentation.
- 6.3 **Opportunistic Intermediaries:** This includes Enterprises which have concluded agreement with other Enterprises with a view to leveraging the Opportunistic Intermediary's favourable BEE Status in circumstances where the agreement involve:
- 6.3.1 significant limitations or restrictions upon the identity of the Opportunistic Intermediary's suppliers, service providers, clients or customers;
 - 6.3.2 the maintenance of their business operations in a context reasonably considered improbable having regard to resources; and
 - 6.3.3 terms and conditions which are not negotiated at arms-length on a fair and reasonable basis.

7 INDICATORS OF FRONTING RISK

- 7.1 Fronting will be identified by reference to the Fronting Risk Indicators as outlined in the table in paragraph 10.4. These risk indicators may be either high-risk or moderate risk in nature.
- 7.2 High-Risk Indicators:
- 7.2.1 the black people which an Enterprise claims are its shareholders, executives or

- management are unaware or uncertain of their role or participation within an Enterprise;
- 7.2.2 the black people who serve in executive or management positions in an Enterprise are paid significantly lower than the market norm, unless all executives or management of an Enterprise are paid at a similar level;
- 7.2.3 an Enterprise only performs peripheral or marketing functions and performs no other significant operational functions as would be reasonably expected from such an Enterprise;
- 7.2.4 an Enterprise relies on a third-party to conduct the majority of core functions normally conducted by Enterprises similar to an Enterprise;
- 7.2.5 an Enterprise cannot operate independently without a third party, as a result of contractual obligations or the lack of technical or operational competence; and
- 7.2.6 any practice which circumvents or attempts to circumvent Codes.
- 7.3 Moderate-Risk Indicators:
- 7.3.1 the black people identified by an Enterprise as its shareholders, executives or management have limited knowledge of an Enterprise;
- 7.3.2 there is no significant indication of active participation by black people identified as top management at strategic decision making level;
- 7.3.3 an Enterprise pays management or administration fees to a Related Person or shareholder with no BEE Status;
- 7.3.4 an Enterprise acquires goods and/or services at a significantly different rate than market from a Related Person or shareholder (Transfer Pricing);
- 7.3.5 an Enterprise obtains loans, not linked to the share acquisition, from a Related Person at an Excessive Rate; and
- 7.3.6 an Enterprise shares all premises and infrastructure with a Related Person, or with a shareholder with no BEE Status or a third-party operating in the same industry where the cost of such premises and infrastructure is disproportionate to market-related costs.

8 INTERPRETATION OF RISK INDICATORS

- 8.1 When expressing their opinion on the BEE Status of an Enterprise, a Verification Agency must consider whether that Enterprise demonstrates evidence of any of the Indicators of

Fronting Risk in paragraphs 7.2 and 7.3. Any indicators so identified must be evaluated in accordance with paragraphs 10.1 to 10.4.

- 8.2 Where no verification from a Verification Agency has been obtained, Affected Decision Makers should also consider these risk indicators before making decisions and are encouraged to apply the evaluation approach contained in paragraphs 10.1 to 10.4.

9 REPORTING ON FRONTING PRACTICES

- 9.1 Verification Agencies are responsible for the identification, determination and reporting of Fronting Risks.
- 9.2 Affected Decision Makers are encouraged to assume responsibility for the identification, determination and reporting of Fronting Risks.
- 9.3 Both the accreditation body and the industry body envisaged in Code 000 Statement 020, must review the accreditation of a Verification Agency if a Verification Agency fails to identify an Enterprise implementing Fronting practices, unless:
- 9.3.1 the Verification Agency can demonstrate that it exercised due professional care and complied with all of its obligations in evaluating the BEE Status of an Enterprise;
 - 9.3.2 the verification analysis was based on misrepresentation, frauds and/or forgeries by the Enterprise; and
 - 9.3.3 an Enterprise has engaged in Fronting practices after the receipt of the Verification Certificate and before a subsequent review by the Verification Agency.
- 9.4 Affected Decision-Makers are strongly encouraged to be observant of Fronting Risks and to report any observed Fronting practices to the minister.

10 GUIDELINES FOR THE DETERMINATION AND EVALUATION OF FRONTING RISK

- 10.1 When Verification Agencies identify an Enterprise which misrepresents its BEE Status, the Verification Agency must inform the Enterprise of its findings. If the Fronting Practice does not cease within 14 days of the report, the Verification Agency must report to the minister.
- 10.2 In order to minimise the instances of Fronting, this statement determines and measure the level of Fronting Risk associated with an Enterprise in accordance with paragraphs 10.1 to 10.4.
- 10.3 The Fronting Risk Indicators will allow Verification Agencies and Affected Decision-Makers

to classify Enterprises according to four different levels of Fronting status. Fronting risk can be calculated by means of the following formula:

$A = (B \times 3) + C$
<p>Where</p> <p>A is the Fronting score indicator representing the potential level of Fronting in an Enterprise</p> <p>B is the total number of high-risk indicators (as identified in paragraph 7.2) evidenced in an Enterprise</p> <p>C is the total number of moderate-risk indicators (as identified in paragraph 7.3) evidenced in an Enterprise</p>

10.4 Based on its Fronting score, an Enterprise can be classified in terms of its Fronting status:

Fronting Status	Fronting Score	Sanctions for Fronting practices	Reporting Requirements
10.4.1 Fraud	N/A (Evidenced by fraudulent misrepresentation of BEE Status)	The BEE Status of an Enterprise will not be recognised and all points will be forfeited	The Verification Agency will immediately inform the Enterprise, and report the entity to the minister if the situation is not resolved within 14 days
10.4.2 Excessive Fronting Risk	Fronting Score ≥ 10	The BEE Recognition Level of an Enterprise will be decreased by one level for every five points (or part thereof) scored on the Fronting index. The Verification Certificate of an Enterprise will carry the notation: 'Excessive Fronting risk',	The Verification Agency will immediately inform the Enterprise, and report the entity to the minister if situation not resolved within 14 days
10.4.3 High Fronting Risk	Fronting Score ≥ 5 but Fronting Score < 10	The BEE contribution level of the Enterprise, , will be decreased by one level. The Verification Certificate will carry the notation: 'high Fronting risk'	The Verification Agency will immediately inform the Enterprise
10.4.4 Low Fronting Risk	Fronting Score < 5	None	None

10.5 If found guilty of fraud or misrepresentation by a court of law, an Enterprise and its directors may be black-listed.

10.6 In cases in which high or excessive Fronting risks have been identified by Verification Agencies, it is incumbent upon the agencies to add a paragraph on the Verification Certificate which describes the Fronting risks.