

G Ethics of forex dealers

1 The forex market is a decentralised market which is not regulated per se as a market. The market place has nevertheless developed its own norms of behaviour. The Association Cambiste Internationale (“ACI”) was founded in Paris in 1955. It has 25 000 members in 83 countries. The ACI is an association of forex dealers which has adopted an international code of conduct and practice for the financial markets known as the Model Code. The Model Code should be adopted by each forex community in each centre where forex is traded. The ACI has no power of enforcement. The crisis of 1998 (referred to by some witnesses as the “Asian contagion” crisis) led to calls for a “new international financial architecture”. The response of the G7 nations was to create the Financial Stability Forum (“FSF”). The FSF took up three themes, one of which was highly leveraged institutions (HLI’s), including hedge funds, and created three working groups to consider the themes.

2 The FSF working group on HLI’s commissioned a study on the effect of HLI’s on small and medium sized economies in 1998. Mr McCauley was the BIS representative on the study group. The study group visited Australia, Hong Kong, Malaysia, New York, New Zealand, Singapore

and South Africa. The study group heard reports of aggressive trading practices such as trading at quiet hours in order to affect an exchange rate; the practice of the “double play” in Hong Kong involving both an attack on the exchange rate (leading to higher interest rates) in conjunction with taking a short position in equities; and there was evidence of “talking your book”: the practice of a large financial institution which takes up a position and then instructs its economist to write an analysis that supports the position. Following on its research, the study group, in collaboration with major commercial and investment banks, drew up a set of guidelines. The guidelines were discussed and endorsed by the bodies responsible for forex market standards in the main financial centres such as London, New York, Singapore and Hong Kong. The guidelines are known as the Trading Principles. The principles which are of a particular interest to the Commission are the following:

“2 Foreign exchange managers have a particular responsibility in the execution of orders at volatile times. Intermediaries should take care to discuss with customers the risks of operating in these environments and the possible scrutiny of actions. Market makers may reserve the right to refuse customer transactions that they feel may further disrupt or have the intent to disrupt the market.

- 4 The handling of customer orders require standards that strive for best execution for the customer in accordance with such order subject to market conditions. In particular, caution should be taken so that customers' interests are not exploited when financial intermediaries trade for their own accounts (eg "front running").
- 5 Institutions and other trading organisations should be attentive at all times to ensure the independence and integrity of any market related research that they publish.
- 6 Financial intermediaries are encouraged to implement rigorous internal guidelines concerning the handling of rumours and possible false information. We strongly endorse the Model Code that dealers should not relay information they know is false or they suspect may be inaccurate.
- 7 Manipulative practices by banks with each other or with clients constitute unacceptable trading behaviour."

Included in the financial institutions which accept the Trading Principles are JP Morgan Chase, Goldman Sachs, Barclays, Citibank, Deutsche Bank, HSBC and Standard Bank of South Africa.

- 3 The Model Code makes recommendations, for example, in regard to:
- gifts: management should monitor gifts given or received by forex dealers and set a clear policy;
 - gambling: gambling or betting among market participants should be strongly discouraged;
 - managers must set clear written rules governing personal account trading;
 - confidentiality: “dealers and brokers share responsibility for maintaining confidentiality and without explicit permission from the parties involved should not disclose or discuss any information relating to deals transacted or in the process of being transacted”;
 - misinformation and rumours: “dealers and brokers should not relay any information which they know to be false and should take great care when discussing unsubstantiated information which they suspect to be inaccurate and which could be damaging to a third party”.¹

4 ACI South Africa has members in thirty organisations, mainly authorised dealers and licenced broking houses. Those thirty organisations employ about four hundred and fifty forex dealers, three

¹ Paragraphs 1 – 3 are based on the evidence of McCauley: Record 30-40

hundred of whom are ACI South Africa members. The Model Code is endorsed by ACI South Africa and forms part of the examination programme that ACI SA provides. Since 1988 more than five hundred trade dealers, brokers and support staff have attended ACI SA workshops. Procedures for breaches of the Model Code are:

- consultations with transgressors before the ACI SA Executive Committee;
- if the dispute is not resolved there, the transgressor's employer is consulted;
- the Reserve Bank is informed of the breach. The forex market in South Africa is nevertheless unregulated. Market participants impose a form of self-regulation by holding themselves bound to the Model Code. During the past eight years only one member has been reported to ACI SA for breaching the Model Code. The trader concerned was dismissed by his employer.

5 Mr Langley² testified that unethical behaviour occurs amongst forex traders in South Africa in these respects:-

² The evidence of Mr M Langley, former Head of Foreign Exchange, Credit Agricole Indosuez, Johannesburg, Expert Bundle 143, Record 209-215

- If the forex market is quiet, a trader wishing to generate volatility starts a rumour to elicit a reaction. The trader does so by “making a story or re-hashing something”.
- Two traders at different banks collude in an attempt to manipulate the rand in one direction or another.
- Trades can be done and then cancelled between two traders at different banks in order to create the perception of actual trade at a particular rate.
- Banks that are known to be very large or act as transactors attempt to disguise their activity by asking another bank to execute parts of the trade on their behalf. In reply to a question by a Commissioner about the extent of unethical behaviour, Mr Langley said that: “It usually happens when it is quiet....When it is volatile, you don’t even have time to get involved in this nonsense...when it is extremely volatile, you don’t have time for this nonsense. [In times of volatility] ...you actually want the phone to stop ringing. You actually want the thing to stop. You actually pray for a quiet day.” He further gave evidence that it is “very, very difficult to actually prove that somebody has been unethical unless it is blatantly obvious”; unethical behaviour is limited; there are a number of banks that do not tolerate any unprofessional behaviour at all; and forex traders “are supposed to trade in an ethical and professional manner at all times”.

6 The president of ACI South Africa, Mr Gibbs, testified that, to the extent that Mr Langley's evidence slanted the forex industry as a whole, he wished to defend the integrity of the industry. In the experience of ACI South Africa, breaches of the Model Code are "few and far between" and its members are generally "outstanding citizens".³

7 Mr De Villiers⁴ gave evidence that the ACI of South Africa has accepted the Model Code and that the "governing authorities and regulators, are in the process of considering whether to do so." In his view, forex traders "should adhere to things that are lawful, honest, that [do] not breach any client confidentiality and that you do not lead your client astray". Starting unsubstantiated rumours in the forex market would be highly unprofessional. Collusion between dealers, of the kind described by Mr Langley, in order to have an impact on a currency would need to take place consistently throughout the day. Collusion of that magnitude would leave an audit trail, which should be picked up and queried.

³ §§ 4 & 6 are based on the evidence of Mr R Gibbs, the President of ACI South Africa, ACI Bundle 1-7; Record 1402-1407

⁴ Evidence of Mr P de Villiers, Global Head of Foreign Exchange Trading, Investec Group, Record 374-378

8 Mr Balt⁵ said that he considered that the following transactions could be considered to be unethical:

- any transaction that runs contrary to the spirit of exchange control rules, ie one that unduly and negatively affects the foreign reserves of the country;
- front running, ie the placement of personal orders by a member of an exchange in advance of client or institutional orders, with the foreknowledge that a movement in price may occur from a large trade;
- breaches of confidentiality falling short of insider trading;
- price manipulation through rumour mongering;
- spreading rumours deliberately to trigger market “stock losses”,⁶ and
- “position parking”.⁷

⁵ Statement of Balt, Group Treasurer, Absa Bank, [Absa Bundle 15.1-15.2](#)

⁶ “Stock losses” may be described as an order where a trade is to be executed if the instrument price hits a specified limit. In the case of a long position, the instrument is to be sold if the price falls below a stipulated level, and conversely, in the case of a short position, the instrument is to be bought if the price rises above a stipulated level. Stop-loss orders are put in place to limit losses to a pre-determined amount.

⁷ “Position parking” may be described as the practice whereby two contract parties agree a deal, usually on the understanding that the contract will be reversed at a specified later date, at or near the original contract rate irrespective of the interim market rate change. The consequence of such an agreement is that for a period of time the obligations of an institution are excluded from its books of account and from management or regulatory oversight.

9 In the Questionnaire,⁸ the authorised dealers were posed the following questions:-

“4.5.1 What ethical standards are applied in the conduct of your foreign exchange activities? Are these documented? By whom were they drafted? Do they differ in any significant manner from the ACI Financial Markets Associations Code of Conduct?

4.5.2 What policies and procedures are followed in order to ensure compliance with these ethical standards?

4.5.3 During the period under investigation, were there any breaches of these ethical standards that you are aware of? Please supply details if applicable.”

10 The response of the major authorised dealers to those questions was in short the following:-

10.1 Absa

Absa staff members are required to sign a declaration to the effect that they subscribe and adhere to the Model Code, together with

⁸ The questionnaire submitted by Deloitte & Touche to the authorised dealers: see Part K and DT report p23

Absa's Personal Account Trading policy and that they have familiarised themselves with the contents thereof.

The corporate finance department maintains a list of companies for whom deals have been executed which may have an influence on those companies' share prices. During regular departmental meetings those names are communicated to all staff members who are involved or have knowledge of the relevant deals. Staff members are prohibited from trading in those companies' securities for their personal account.

Absa employees are required to maintain a register of their personal account portfolios. The registers are provided to the decentralised compliance officer on a monthly basis. The compliance officer provides the Absa Group Compliance Officer with the information quarterly. Trends are reported to the Absa Group Audit and Compliance Committee.

Breaches, being a deviation from Absa policy, are regarded as misconduct. Absa's disciplinary process will be instituted against any employee guilty of such misconduct. Based on the monthly returns received for the period under review, there were no breaches of those ethical standards.⁹

⁹ Evidence of Ms R Potgieter, Head: Compliance and Operational Risk of Absa Corporate and Merchant Bank, a division of Absa Bank Limited, [Absa Bundle 67-68](#)

10.2 Nedcor

The ethical standard applied in the conduct of the bank's foreign exchange activities is the Model Code, which forms an integral part of the policies and procedures documented by the risk management area. One of the policies provides: "All dealers must be conversant with the Code of Conduct of the ACI and must at all times conduct themselves in accordance with this Code of Conduct."

In addition to the ethical standards contained in the Model Code, the bank has formulated additional and more detailed ethical standards contained in more than eighty policy documents.

There are many specific policies and procedures in place to ensure compliance. Examples are:

- an internal induction process;
- annual competency tests;
- there is limited access to the dealing room via security cards;
- no mobile telephones are permitted in the dealing room;
- all telephone calls to and from the dealing room are recorded;
- security videos monitor the dealing room;

- there are procedures in place to prevent the destruction of video and telephone recordings;
- there is daily monitoring of the dealers by controllers and managers.

Any known contraventions of policies and procedures will lead to disciplinary action in accordance with the bank's disciplinary procedure. The bank has a policy of zero tolerance towards crime. It is the policy of the bank to identify and properly investigate any possibility of irregularities against and within the bank and, when appropriate, to pursue disciplinary action, as well as employ civil and criminal legal remedies available under the law to ensure that the bank maintains a culture of "zero tolerance" towards crime.

There were no material breaches of policies and procedures relevant to the terms of reference of the Commission for the period under investigation.¹⁰

10.3 NIB

The Model Code has been accepted as the ethical standard for NIB treasury. All forex dealers are ACI members and have

¹⁰ Evidence of Parker, Nedcor Bundle 14-17

formally accepted the Model Code. The Model Code and certain additional internal requirements have been incorporated into the NIB policies and procedures manual.

The policies and procedures in the manual are monitored on a regular basis by chief dealers, heads of departments and the treasurer. The independent risk and compliance function monitors compliance on an ongoing basis. The bank is subject to regular internal and external audits as well as regulatory inspection. All complaints of unethical behaviour by personnel are investigated promptly and in depth. Similar measures as those implemented by Nedcor (see §10.2 above) have been implemented at NIB.

As far as the bank is aware there were no breaches of ethical standards relevant to the terms of reference of the Commission of the period under investigation.¹¹

10.4 FirstRand Bank

All the bank's trading activities are housed within Rand Merchant Bank ("RMB"), a division of the bank. RMB's Code of Conduct does not differ in any significant way from the Model Code. RMB's code of conduct applies to all employees of RMB, and where adherence to the Code is required in terms of their

¹¹ Evidence of Lane, NIB Bundle 17-19

employment, to employees of other members of the Group. In addition, the market risk management framework of the bank applies to all trading activities. The framework prohibits unethical or illegal practices.

Every employee is bound by RMB's Code of Conduct insofar as it forms part of his or her employment contract. Each employee is required to sign an employee declaration pertaining to the Code of Conduct. Compliance officers in each division of the bank are required to monitor adherence to all compliance-related issues and procedures and to report any non-compliance to the RMB Compliance Officer. A data base to record events of non-compliance has been established and a compliance training programme is in the process of being rolled out.

A member of staff was reported to the Reserve Bank for a contravention of exchange controls. Save for that one incident, there were no other breaches of RMB's ethical standards that it is aware of during the period under investigation.¹²

10.5 Investec

Investec applies general standards of integrity, honesty, lawfulness and client confidentiality in its forex activities.

¹² Evidence of Bester, FirstRand Bundle 8-9

Investec has a published Code of Conduct, which is not specific to forex activities. Investec's application of the standards of conduct in the Code of Conduct is not in conflict with the Model Code.

Processes and controls to ensure compliance with ethical standards were documented some time ago by external auditors. Reliance is primarily placed on ensuring proper segregation of duties. The bank's board audit committee will ensure compliance with ethical standards, processes and procedures.

The bank is not aware of any breach of ethical standards during the period under investigation.¹³

10.6 BoE

All business activities of the BoE Group, including the bank's foreign exchange activities, are governed by the Group's Code of Ethics ("the Code"). In terms of that Code all staff are required to "conduct themselves in a professional manner and according to the highest standard of conduct and ethics". The Group's philosophy is stated to be "to conduct our affairs with uncompromising honesty, integrity, diligence and professionalism."

¹³ Evidence of De Villiers, Investec Bundle 33

All of the Group's staff, including staff involved in forex transactions, are obliged to sign a copy of the Code acknowledging that they have read and understood it upon obtaining employment with any division of the Group.

The Code and all other ethical standards that the staff of BoE are required to follow are enforced through the Group risk management and Group compliance frameworks.

To the knowledge of the bank there were no breaches of the Code by any staff involved in forex dealing during the period January 2001 to December 2001.¹⁴

10.7 Citibank

Citibank subscribes to the Model Code and its forex dealers adopt the Model Code. The bank complies with its own internal standards and procedures described in two documents, the Statement and the Handbook.

All new bank employees undergo induction training, which covers the Citi Group ethical standards of personal and professional integrity on all aspects of the employment relationship with Citibank. New employees acknowledge receipt in writing of the Statement.

¹⁴ Evidence of Little, BoE Bundle 5, 29

The following measures are also employed:

- compliance grids are signed off on a regular basis to ensure awareness of and compliance with ethical standards;
- all deals done during the day are reviewed by comparing the rate at which transactions were dealt against rates prevailing in the market at the time of transacting;
- deals are flagged if they do not fall within market rates and are reviewed independently;
- all telephone conversations held within the dealing room are recorded;
- all Reuters conversations are printed and all conversations resulting in a transaction are retained;
- the bank is a signatory to the Financial Stability Forum's Trading Principles, which have been incorporated into the bank's guidelines and Codes of Conduct.¹⁵

10.8 JP Morgan

¹⁵ Evidence of Scott, Citibank Bundle 25-26

The ethical and general standards required to be followed by the bank's employees during 2001 were set out in Chase's Code of Conduct, which incorporates trading and investment guidelines, Chase and Morgan's Worldwide Rules and their respective compliance manuals (collectively called the "Chase Code"). The Chase Code sets out broadly similar standards of conduct to those contained in the Model Code.

Every employee is obliged to comply with the Chase Code and with all relevant laws, regulations and internal policies. Regular compliance training is conducted by the compliance function of the bank. All the bank's traders are subject to the Chase Code which is rigorously enforced. Employees who breach the Chase Code are disciplined.

The bank is unaware of any breaches of the Chase Code at the bank during 2001.¹⁶

10.9 Deutsche Bank ("DBJ")

DBJ has a procedures manual for forex dealing which was drawn up by the compliance department. The procedures manual aims to ensure ethical standards and provides for all other aspects of forex trading on behalf of DBJ. DBJ subscribes to the Model Code.

¹⁶ Evidence of Coulter JP Morgan Bundle 18-19

DBJ is not aware of any breaches of those ethical standards during the period under investigation.¹⁷

10.10 SCMB

In addition to the regulatory framework, SCMB subscribes to the Model Code. SCMB also adheres to more general principles of good banking practice, such as customer confidentiality and avoidance of conflict of interest, some of which are documented in the Standard Bank Code of Business Ethics. SBSA's internal audit and compliance functions monitor adherence to law, regulations and internal policies. The procedures implemented by SCMB in order to ensure compliance with policy, include the following:

- upon entering the service of SCMB, each employee is required to sign an agreement, which includes an undertaking to maintain confidentiality in respect of customer information. In terms of SCMB's disciplinary code, disclosure of confidential customer information may result in dismissal;
- nominated employees who have access to confidential information or who may be in a position of conflict of

¹⁷ Evidence of Mr NG Morrison, Managing Director of DBJ, Deutsche Bank Bundle 8-9

interest are required to sign a policy document dealing with personal account trading.

70% of SCMB's foreign exchange dealers are members of the ACI and have been involved in many workshops and discussions on the subject. Senior staff members of SCMB lecture the subject to junior dealers internally and externally at the invitation of ACI. SBCA has a policy of training its own dealers and junior staff members are given on-the-job training and are regularly subjected to internal exams. There is also a mentor/mentee programme in terms of which all junior and middle management staff participate. Back office payments, confirmations and reporting procedures are segregated operations with a different reporting structure, as is the case with the general risk management principles operating in SBSA.

SCMB is not aware of any breaches of the Model Code or the principles contained in its Code of Business Ethics during 2001.

- 11 In the replies to Deloitte & Touche, most of the authorised dealers said that they do subscribe to the Model Code. Those that do not, have internal codes of conduct that do not differ significantly from the Model Code. Authorised dealers indicated that they have internal control

frameworks designed to identify, inter alia, breaches in ethical conduct. Breaches of the codes of conduct to which they subscribe are infrequent and are met with disciplinary action and possible dismissal. There were no breaches of any codes of conduct material to the Terms of Reference of the Commission during 2001.¹⁸

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Report of the DT team p 23