

PROCEEDINGS RESUME ON 10 APRIL 2002:

CHAIRPERSON: Gentlemen, let us commence today's proceedings. Today we are hearing the evidence of Nedcor Bank Limited and Nedcor Investment Bank. The first witness is Mr Parker.

5 MARK STEPHEN PARKER d.s.s.

MR NAIDU: Mr Chairman, for the record, my learned friend, Mr Subel SC, appears for both Nedcor and NIB. It is proposed to call a Mr Parker to testify on behalf of Nedcor Bank, followed by Mr Peter Lane on behalf of NIB and Mr Dennis Dykes to present an economics view on behalf of both banks.

10 CHAIRPERSON: Thank you.

MR NAIDU: The documents, Mr Chairman, will constitute, with your leave, a bundle referred to as Nedcor/NIB in the order of the witnesses' statements.

CHAIRPERSON: Fine. Right, let us start with Mr Parker then.

15 EXAMINATION BY MR NAIDU: Mr Parker, are you employed by Nedcor Bank and have been so employed since 1974 and are you currently, since 1983, the Executive General Manager: Treasury at Nedcor Bank? --- Yes, I am.

And is your responsibility for the Nedbank Treasury Division as well as for Nedbank Asia and Nedbank London total businesses? --- That is correct.

20 You have prepared a statement in the bundle, do you confirm the contents of this statement? --- I do.

And do you appreciate that this statement once handed in constitutes evidence before this Commission? --- Yes, I do.

25 And for the understanding of the Commissioners, is it correct that both Nedcor and NIB had prepared fairly detailed statements by various personnel in both banks to deal with specific issues and at the request of the legal team acting for the Commission these statements were condensed to those presently before the Commission to present a representative view? --- That is correct.

30 And is it correct that you are going to testify both in relation to matters that you have personal knowledge and in relation to matters about which you obtained information from other employees at the bank? --- That is correct.

And if there is any difficult would you request leave of the Commissioners to either consult with the persons who have the relevant expertise or to present a subsequent statement setting out the information required by the Commission? --- I will do so.

35 In your statement, in paragraph 2, you deal with the Group Structure of Nedcor Bank which is set out in Parker 1 on pages 30 to 35, is that correct? --- That is correct.

And you identify in paragraph 2.3 the key personnel that is connected with foreign currency? --- That is correct.

40 In paragraph 3 you deal with the markets in which Nedcor Bank operates through from page 3 to page 4, the middle of the page? --- Yes, I do.

Would you like to make any comments in relation to paragraph 3.2 of your statement on page 4? --- I think basically what we are saying is that market making involves a degree of speculation, that a market maker will normally attempt to position himself in terms of the view of the market on that day and it is necessary to do so to be able to quote competitive prices during the day and to fulfil the role of market making.

45 In paragraph 4 you identify the products in which Nedcor operates and in 4.3 you make the point on page 6 of your statement that no securities lending or borrowing transactions were concluded during the relevant period by Nedcor Bank, whether in a custodial or non-custodial operation? --- That is correct.

50 In paragraph 5 you identify by reference to Parker 2 the way in which risk oversight committees work? --- That is correct.

And in paragraph 5.1.3 you speak of the treasury risk control unit? --- That is correct.

55 Would you like to either read or explain this unit where it appears in 5.1.3? --- We have independent oversight of trading risks and it is performed by Nedcor group's treasury risk control unit, which is independent of the business areas, and has ultimate accountability to the Nedcor board. The treasury risk control unit consists of trading market risk management, treasury trading credit risk and treasury middle office and is structured to promote an integrated approach to the management of treasury market, credit and operational risk. The skills required to operate such a department include financial risk
60 management skills, quantitative analytical skills, strong communication and consensus-

building skills, product knowledge, practical knowledge of the trading and valuation processes and expertise in multiple-technology environments.

In paragraph 5.2 you identify the risks and the manner in which they are managed?

--- That is correct.

5 And in paragraph 5.3 you identify the three different methods by which market risk exposures are measured? --- That is correct.

And those are sensitivity analysis, Vat-at-Risk and stress scenario analysis? --- That is correct.

10 And in 5.4 you make the point that identical policies apply for all local and foreign elements but with very restrictive limits in respect of respect of the foreign elements? --- That is correct.

In paragraph 5.5, would you read that please? --- The limit framework including exchange control limits. Net open position limits are laid down by South African Reserve Bank, but internal Nedcor Bank limits approved by the board of directors are more conservative. No limits were exceeded during the year January to December 2001.

15 And is it correct that during 2001 there were no adjustments or excesses of intra-day limits? --- That is correct.

You identified percentage limit utilisation of Nedcor Bank foreign exchange risk exposure limits, in 5.7.1 on page 10 of your statement? --- That is correct.

20 And in 5.7.2, is it correct, that you make the point that Nedcor Bank dealing room was positioned, on 60% of the trading days in December 2001, for the rand to strengthen? -- - That is correct.

In paragraph 5.8 you set out the procedures to monitor compliance with limits during the year under review? --- That is correct.

25 Would you like to briefly discuss the compliance with SARB regulations as is set out in paragraph 5.9 of your statement. --- We have a centralised exchange control department.

This is the reference point for all exceptions and plays an advisory role to all business units in respect of SARB and exchange control matters. In 5.9.1.2 to 7 we cover some of the operational aspects of the department in question.

30 And can you tell us about what is done regarding the verification of exchange control compliance and its management? --- The point during a foreign exchange transaction at which compliance with exchange control is verified, depends on the nature of the transaction.

In respect of cross border pay-away of funds, compliance is verified prior to processing of the pay-away. In respect of other transactions, a risk/compliance management process has been implemented, which includes procedures such as independent sampling and regular internal audit reviews. In addition we are subject to periodic inspections by the SARB.

You identify in Parker 3 which constitutes pages 36 and 37 of the Nedcor, of your statement, the detailed procedures to ensure compliance with the 180 day rule? --- That is correct.

40 CHAIRPERSON: Can you just tell us, I am just skimming through this quickly. You are telling us here about your procedures. Do you tell us about whether the 180 day rule was in fact complied with during 2001 or does somebody on behalf of Nedcor tell us that? --- It was complied with and exceptions were followed up and reported to the central bank.

45 MR NAIDU: In Parker 4 you detail procedures to monitor CFC accounts and this is contained on pages 38 and 39 of your statement. Can I refer your attention to paragraph 13 on page 39. Would you like to deal with that please? --- The Reserve Bank requires that when transferring funds between CFC accounts, the authorised dealer effecting the transfer must make use of a free format MT100 and quote the date on which the funds were originally credited to a CFC account. We attempt to apply this to the best of our ability to comply with this requirement. The difficulty therewith arises from the fact that where funds are transferred between CFC accounts at different authorised dealers, the total amount transferred may be made up of smaller amounts that were originally credited on various dates over an extended period not exceeding 180 days. It is our understanding that other authorised dealers have similar difficulty in adhering to this aspect of the SARB requirements.

55 CHAIRPERSON: Is the Reserve Bank aware of that difficulty? --- I would like to, I believe to, I would like to just ask one of the colleagues to confirm that that has been reported.

MR MORIATIS: Mr Chairman, we can put it on record now that we know that the Reserve Bank is dealing with it. --- We can confirm that we indicated that to the Reserve Bank in a specific letter addressed to the Deputy Governor, Ms Marcus, on 30 January.

60 CHAIRPERSON: Thank you.

MR NAIDU: In 5.9.5 you deal generally with overdrawn Vostro accounts and in 5.9.5.2 you identify the way in which Vostro accounts are monitored? --- That is correct.

Can you just explain briefly why it is necessary to monitor these accounts? --- It is an exchange control requirement that rand is not advanced to non-residents and therefore any overdrawn account would constitute a breach of that requirement and we are required to monitor it.

In 5.9.6 you highlight the percentage of accounts handled which were transgressed and is it correct that out of a total of, the Nedbank operates 3 961 CFC accounts? --- That is correct.

And the excesses over limits are managed as part of the credit risk management process? --- That is correct.

Are you aware or are you able to comment about whether the overdrawn account accounts had any effects or had contributed to the rapid depreciation of the rand? --- We do not believe that overdrawn accounts had any impact on the performance of the rand.

And were there any material differences between the daily average US dollar debit balances for the months of 2001? --- There were no material differences.

So far as Vostro accounts are concerned, of the 250 Vostro accounts only 10% of the total accounts were overdrawn on a daily basis, is that correct? --- That is correct.

In paragraph 6 you deal with the ethics and compliance and in 6.1 you identify the ethical standards that are adopted by Nedcor Bank? --- That is correct.

Would you like to either read or deal briefly with the standards as set out in 6.1.1 to 6.1.3? --- The ethical standard applied in the conduct of our foreign exchange activities is the ACI Code, which forms an integral part of the policies and procedures documented by our risk management area. An extract from our policies and procedures reads as follows: "All staff members will conduct themselves in a proper and professional manner and in accordance with laid down policies and procedures, at all times. All dealers must be conversant with the Code of Conduct of the A.C.I. and must at all times conduct themselves in accordance with this code of conduct. All transactions concluded will be dealt in accordance with standard market terminology and conventions."

And are all your staff expected to sign this document? --- That is correct.

In Parker 5 you identify the additional ethical standards and policies adopted by Nedcor? --- That is correct, there is approximately 80 policies relating specifically to the ethics element, that is out of a total of 532 specific policies, totalling approximately 1 800 A4 pages.

And do you have any comment to make in respect of 6.1.3 of your statement on page 15? --- The ethical standards were drafted internally by employees of Nedcor Bank incorporating the ACI Code. There are no significant differences from the ACI Code, since the ACI Code itself has been incorporated into Nedcor Bank's ethical standards.

In paragraph 6.2 you make the point that there are many specific policies and procedures to ensure compliance and you identify those in 6.2.1 to 6.2.9? --- That is correct.

And what are the consequences for a contravention of these policies and procedures? --- Any known contravention of policies and procedures will lead to disciplinary action in accordance with our disciplinary procedure.

To your knowledge has any disciplinary action been taken arising out of a violation of these policies and procedures? --- Yes, we had one incident last year.

Were there any material breaches of - you said there was just one during the period under discussion, and is that a matter which is subject to your internal arbitration process? -- - That is correct.

In 6.4 you deal with Nedcor Bank's attitude to disciplinary infractions and in 6.5 there is a reporting procedure to more senior levels with regard to these material breaches including ethical standards? Would you like to comment on that, 6.5 on page 17. --- I would like to point out that Nedcor Bank has a policy of zero tolerance towards crime supported by an intensive internal fraud and security awareness campaign promoting vigilance amongst staff and exposing perpetrators thereof. Under 6.5.1 I mention that all breaches are recorded and escalated based on the material impact or severity of these breaches. Breaches are classified in accordance with the material limits set by Nedcor Group and the Old Mutual plc.

And in 6.6 you deal with the monitoring frequency of the regulatory risks and in 6.6.3 you identify two types of monitoring conducted with regard to ensuring regulatory compliance. Can you just deal with them briefly? --- We have routine monitoring activities, that is continuous monitoring of regulatory compliance within operational daily activities. In

addition to that we have ad hoc monitoring to detect breaches.

Would you like to deal with the ethics of trading in the rand as set out in paragraph 6.7. --- In paragraph 6.7 we deal with the ethics of trading in the rand. We do not regard profits or losses generated or sustained by us from trading of the rand, which trading took place within the regulatory framework and our codes of conduct, to be unethical or improper in any way. As a registered bank, it is our responsibility to act within statutory, regulatory frameworks and the ACI Code.

In paragraph 7.1 you deal with the SARB Circular dated 13 October and the events that followed. If you would like to deal with that please? --- The intent of the SARB to enforce existing rules which had not been strictly enforced, was communicated to the CEO's and treasurers of banks on Sunday 14 October by the Governor. A written copy of the Governor's statement dated 15 October (that is D341) was received after the meeting on Sunday. A further circular dated 16 October (D342) differed in some respects from what had been understood from the Governor. These perceived differences caused confusion both amongst domestic and international participants and reduced market participation and therefore liquidity at that time. Under the auspices of the ACI S.A., a meeting was held with the Reserve Bank after 16 October to clarify the precise requirements, which were then resolved by a technical working group. Approximately a week later the technical problems were resolved with allowed some normality back into the market. It should be noted that foreign banks generally were not happy with the measures being taken. Some of them sought legal opinions, which advised that they should not submit the required compliance confirmations. We believe that the circular was one of the many factors which contributed to the depreciation of the rand, as it drew attention to concerns about the market but did not in fact prevent ongoing speculation against the rand. The Reserve Bank made it clear that it did not want to restrict trading, but merely wanted to enforce existing rules. The Reserve Bank made it clear that spot trading was not affected in any way. Non-residents had always been free to hedge their underlying exposures and when the Reserve Bank re-confirmed that they were free to hedge in circumstances where the rand was extremely volatile, the concern was that whereas non-residents had not hedged their underlying exposures in large volumes previously, this might turn out to be the case thereafter. The markets therefore became increasingly nervous at that point. Under the circumstances some foreign players re-assessed their involvement in the rand market, further exacerbating illiquidity. After 13 October 2001, notwithstanding the lack of active participants in the rand providing two way prices as evidenced by the significant increase in the bid offer spread (in certain instances up to 1 000 points), Nedcor Bank continued to provide a professional service and attempted to quote an ongoing two way price at all times during usual trading hours. Our willingness to assume overnight exposure in the currency diminished as rand volatility increased with one month volatilities peaking at 60%, reflecting considerable risk. And if we one goes back to the table showing our limit utilisation, you will note that in December we were down to approximately 10% utilisation, a considerable risk reduction at the time. There were times during December 2001 where we were one of very few banks prepared to quote a price in the currency.

In paragraph 7.2 you deal specifically with the state of trading with corporates and non-resident banks after 13 October and in 7.2.5 you mention that Nedcor had sent out 165 requests during that period and received just 35% of compliance? --- That is correct, that relates to the compliance request from, as to foreign correspondent banks, to confirm that their trade that they conduct in the rand were compliant with the specific requirements.

In paragraph 8 you deal with the impact of the depreciation of the rand on the bank's results and activities and you set out in Parker 6 on a matrix basis the profit and loss in an indexed format of Nedcor Bank from forex dealings in the year under review? --- That is correct.

In paragraph 8.3 you identify the hot trading days during 2001 and the spreads in respect of these days in 8.3.2? --- That is correct.

What is the position if you refer to 8.3.4 regarding 14 December in so far as the spread is concerned? --- On 14 December some inter-bank market makers widened their spreads to 1000 points. This remained the case throughout December, whilst a few players continued to quote 500 points.

In Parker 7 you table details of an activity, from an activity report of the desk head concerning the market for the relevant hot days? --- That is correct.

60 CHAIRPERSON: Could we just pause there for a moment and go back to your hot trading

days in 8.3.1 which you define as being days of exceptional volatility and is my understanding right that what Nedcor is saying is that prior to 14 October there were days of exceptional volatility, namely 10 January and 8 March, and then subsequent to 14 October the days that you have enumerated? --- That is correct.

5 And then if we look at the next paragraph, the spreads remain the same for the first hot spot days and then in November they pick up to 400 points and eventually by 21 December they are 500 points? --- That is correct.

Yes, thank you, you may continue.

10 MR NAIDU: In paragraph 9 you deal with Nedbank's view regarding transactions which could affect the rand. In paragraph 9.2 you say that you are not aware of the existence of any significant short scrip/stock borrowing positions or related positions in the underlying financial instruments after 1 September involving offshore entities? --- That is true.

15 CHAIRPERSON: Just in regard to that paragraph, why did you choose the day, 1 September, what about earlier in the year? --- I adhered to the questionnaire that was submitted to the bank.

Identified this period? --- Yes.

In other words, the volatile period? --- Yes.

Is that really the answer? --- That is correct.

20 And what is a short scrip? --- We do not enter into these transactions but it is where a counter party may have sold an instrument short and in order to deliver would have to borrow that instrument from somebody who has underlying to make good the delivery.

Thank you. Right, let us continue then

25 MR NAIDU: I refer your attention to paragraph 9.3. I would like you to comment on whether any clients with credit limits of R50 million or more exceeded their credit limits by more than R5 million for the period exceeding seven days or more during 2001? --- In so far as we are aware no clients with limits over R50 million exceeded their credit limits by more than R5 million.

And you identify the categories under which the various excesses did occur in 9.3.1 to 9.3.4? --- That is correct.

30 And in 9.4 you make the point that there were four rand-denominated facilities to non-residents during 2001, none of which exceeded USD 21 million? --- That is correct.

35 Can you comment on paragraph 9.5 to your statement very briefly on the contraventions of the exchange control regulations? --- Nedcor picked up a total of 72 contraventions which were reported to the Reserve Bank during 2001. The table 9.5.1.2 reports the trends of the contraventions and the approximate total relating to these contraventions was R716 million for the period.

40 In 9.5.2 you deal with illegal or unethical transactions giving rise to the rapid depreciation of the rand and is it correct or can you comment on whether to your knowledge there were any illegal or unethical transactions in the operation of the bank which gave rise to the rapid depreciation of the rand? --- We are not aware of any such transactions.

And to your knowledge in the course of the bank's operations were there any person or persons who might have made any improper gain or improperly avoided loss from the rapid depreciation of the rand? --- We are obviously not aware of any such actions.

45 CHAIRPERSON: Mr Parker, in that regard, did Nedcor Bank take steps after the appointment of the Commission to internally investigate these issues? Did you establish a process so that you could speak for Nedcor Bank? --- We had a full review and used all our risk management entities to confirm the information that has been provided in this submission.

Thank you.

50 MR NAIDU: You make certain recommendations in paragraph 10 regarding the administration of exchange control. If you would like to deal with that, Mr Parker? --- In our opinion the problems are as follows: Divergent interpretations of authorised dealers in respect of certain aspects of Reserve Bank rulings. The competitive nature of the market places an authorised dealer at risk of losing client business in the event of overly strict interpretation of certain rulings. Lack of transparency of exchange control related information between Reserve Bank and authorised dealers, pertaining to specific approvals granted to multi-banked customers. The current requirement for the presentation of paper-based documentation to support cross border payment transactions is not necessarily effective and is open to abuse. Such documentation is easily replicated. Initiatives to improve processing efficiencies through automation in the relevant back office environments, are restricted by the

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current high-cost, manual, paper-based exchange control requirements. The difficulty of enforcing compliance with South African exchange controls against foreign banks. The accurate matching of multiple debit transactions against credit transactions of CFC accounts can be problematic. This is further complicated where clients maintain multiple CFC
5 accounts at more than one authorised dealer. And in 10.2 the recommendations are as follows: As I have already stated, paper based supporting documentation is open to abuse and fraudulent replication. It is therefore recommended that compliance with Exchange Control Regulations be based on the electronic monitoring of trade and payment transactions wherever possible. This would require the alignment/integration of databases of the relevant
10 parties involved in trade transactions, i.e. SARS, SARB and authorised dealers. The level of compliance could be improved by placing more emphasis on the accountability of customers who hold CFC accounts. A process similar to the current "Letter of Undertaking" for import and export clients could be used for these account holders. Restrictions could also be placed on the movement of funds between CFC accounts held by persons at different
15 authorised dealers. We have made reference to the difficulty of monitoring funds held in such accounts in attachment Parker 4. In addition to the abovementioned specific recommendations, we would suggest that a representative forum be established to review existing and/or planned future exchange controls, agree on procedures/processes which will ensure high levels of compliance and ultimately improve the effectiveness of such controls.

20 We would like to reiterate our willingness to co-operate with the Commission at all times and assist the relevant authorities where appropriate with regards these matters.

Thank you, Mr Commissioner.

MR MORIATIS: Chris Moriatis from the South African Reserve Bank. Just one point of clarification which I think we would like to deal with from the Reserve Bank's part. On page
25 39, paragraph 13 in particular, you mention the difficulty when it comes to smaller amounts being transferred in CFC accounts. You also mention that this was reported to the South African Reserve Bank, I think it was on 30 January. You however did not mention the year when this was reported to Deputy Governor Marcus. Are you aware of it? --- This is in fact January 2002.

30 Thank you.

MS QUNTA: Mr Parker, if I can take you back to page 19, paragraph 7 which deals with the circular. Maybe before I start my questions I could just say, I think you are aware that the Commission is doing an independent investigation into authorised dealers which is separate
35 from this process. Are you aware of that? I think, I do not know if senior counsel mentioned that or the investigation team would have mentioned to you that there is a separate investigation going on in terms of the terms of reference of the Commission. --- I am aware that an analysis is taking place of the data that we have submitted.

Well there is an investigation going on, we are looking at transactions that took place during the course of 2001. The gathering of analyses is just the first part of that investigation
40 and I assume that you have been informed by the investigating team that that is the case, so that my questions that I am now asking are very general questions based on what you have given here. Should there be any further issues arising which affect Nedcor or NIB, you know, we will obviously ask you, I may have further questions to ask. --- Okay.

If you can go to - in 7.1 you say there that there were certain existing rules which
45 had not been strictly enforced by the Reserve Bank. To your knowledge were there rules and do you have any information to back up that statement? --- Yes, the rules that we are referring to specifically relates to the requirement of authorised dealers to determine whether there is an underlying transaction before quoting a foreign bank a Dollar/rand rate. It was a matter of asking is there an underlying transaction and getting confirmation, yes, before
50 quoting this became impractical and those who tried to do it strictly would then be bypassed by the foreign banks seeking rand prices. So essentially it was a measure that had fallen into disuse as a result market practices, it was not practical to do that in the normal course of trading.

So are you saying therefore that a fair authorised dealer was .. (inaudible) would
55 merely ask verbally from the counter party whether there is an underlying transaction and based on the answer given by that counter party it would then accept that as correct without checking whether in fact there is one? --- That is correct, it may on occasions be verbally, alternatively it would be through the electronic dealing mechanism of Reuters where you would have asked that question and had it on record.

60 And then, as you say, it sort of fell away because of the market exigency? --- That

is correct.

Now it then means that authorised dealers did not comply with exchange control regulations, is that what you say, strictly? --- The answer to that is yes but with the knowledge of the central bank of the impracticalities of applying that specific requirement.

5 Did you communicate then to the Reserve Bank that you are not able to enforce the exchange control regulations with regard to the underlying commitment? --- I believe the Central Bank was aware of the issues relating to that specific .. (intervenes)

No, that was not my question, my question is did Nedcor inform the Reserve Bank that they are not able to comply with that particular rule? --- Yes, we did.

10 Was that in writing or oral? --- No, that would have been oral, in discussion around the market.

And what was the response from the Reserve Bank? --- I do not recall their specific response on those discussions, I would have to consult with colleagues of mine who had been at those specific discussions. I think the answer was that it would have been noted and that is subject to confirmation.

15 Perhaps the Reserve Bank can assist the Commission with regard to that particular issue. The actual statement now, if we could come to the statement of 13 October. We heard evidence from the Governor of the Reserve Bank, Mr Mboweni, that the reason for the statement was that they had begun, in fact from Mr Bruce-Brand too, that they had been, the Reserve Bank had been informed by players in the market that exchange control regulations were not being enforced properly and that there were in fact problems in that regard and as a result the Reserve Bank felt it was important to re-state its intention to enforce such exchange control and in the course of that evidence Mr Mboweni indicated that while it is possible, as you have indicated and several other banks, that the effect of that statement, intended or not, was to reduce liquidity in the market. But he has also given an indication that he thinks it may have gone the other way, that players who were engaging in speculative activities without underlying commitments, a whole range of other practices, once they discover that the Reserve Bank would in fact enforce those regulations, they exited the market. Would you have a comment on that? --- You know I am not sure as to the reasons why they would have exited the market, I think they were perhaps not happy with the compliance requirement and our statistics illustrate the response to that. I think there was confusion as to specifically what was allowed and I think in the early stages just after that was communicated verbally a number of participants understood that spot trading even was not allowed. It in fact turned out that spot trading was allowed, there was no restriction on that which was subsequently clarified. So it was just a function of additional confusion in the market and I guess perhaps not just for compliance reasons but maybe for risk reasons certain participants elected to withdraw.

20 Did Nedcor attend the meeting that the Reserve Bank called on Sunday, the 13th, I think it was 13 October. We have heard evidence that a meeting was called where the senior people, I think the heads of Treasury, were called by the Reserve Bank to explain the import of their statement that was going to be issued the following day. Was Nedcor present at that meeting? --- Yes, we were.

And the issues you have raised here with regard to the circulars, did you raise any objection or any concern with the Reserve Bank at that stage? --- Not at that meeting.

45 Did you understand the rationale for the circular? --- Yes, we did.

And was Nedcor part of the authorised dealers who the Reserve Bank worked with to draft a circular to clarify exactly what was contained in that statement? --- Yes.

Which then went out, I believe, the foreign banks. Were you part of the drafting of that? --- Yes, we were.

50 Just a last question, are you, as Nedcor are you involved in both the inter-bank market and you also trade on behalf of clients, would I be correct? --- We participate in the inter-bank market and we provide a service to clients in terms of foreign exchange.

I just have one more question, if you go to 10 - no I think you have already answered me in relation to 10. I have no further questions.

55 MR GANTSHO: I have one clarification question. Mr Parker, when discussing the hot trading days in paragraph 8.3, you referred us to Parker 7 on page 44 and at the bottom of that page, from 22 October onwards you make a statement that you played a long side because of the close above 9.25. Can I just confirm that you are referring to holding the Dollar, you were holding a long position on the Dollar and a short position on the rand? --- That is correct, that is what the trader would be referring to.

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CHAIRPERSON: So whenever you talk about the long side, that is what you mean? I see you use that phrase again .. (intervenes) --- That is correct, that is the terminology that the dealers use. This is an extract from the actual report that the dealers write on a daily basis.

Thank you.

- 5 MR GANTSHO: So let me just clarify once more, this means you are holding a short position on the rand, you are selling the rand short? --- That is correct.

Can you elaborate on the reasons for doing that? --- Well that would have been the, it is within limits obviously and the dealer would have been maintaining a long Dollar position because of or a short rand position because of their view at that point in time.

- 10 CHAIRPERSON: Their view of what? What would their view be? --- That the rand would depreciate further having triggered the technical point of 9 points to 5 on the chart relating to technical trading analysis that the dealer would have been doing at that point.

MR GANTSHO: Is it correct to characterise that that is speculating on the rand, Mr Parker? -
--- That is correct.

- 15 Would you regard that as ethical or unethical? --- No, we believe it is ethical within the constraints placed on the dealers and the market place and very much in line with international practice for that type of position in a bank.

Just for clarification again, there would have been no underlying transactions for doing that, it is just normal practice, is that your answer? --- That is normal practice, you need a position to quote off in any event as a market maker.

- 20 No further questions.

RE-EXAMINATION BY NAIDU: Arising out of the last question, Mr Parker, would you comment on what transactions you consider that may be not illegal but unethical? --- I think, it is a difficult question to answer but any form of price manipulation probably falls into the category of unethical. We have seen instances of rumours being started by participants in the market to get a move going specifically relating to the rand, that happened on a number of occasions during the last few years. We would deem that to be highly unethical. Possibly front running of large orders, although that is difficult to pin down specifically. Dealing on incorrect rates and holding a counter party to that would be deemed to be unethical behaviour and the same applies to holding patently incorrect rates, holding brokers to that, that is covered in the code of conduct, advising of customers, giving them wrong information to induce them to deal would also fall into the category of unethical. As it happens unethical could also be that in thin markets where stop loss orders have been left with a bank to try and force the market in a direction to trigger those stop loss orders. Those are the instances, the examples that come to mind.

- 35 Thank you, Mr Chairman.

CHAIRPERSON: You may stand down.

NO FURTHER QUESTIONS

- 40 MR NAIDU: The next witness will be Mr Peter Lane.

PETER HENRY LANE d.s.s.

EXAMINATION BY MR NAIDU: Mr Lane, have you been employed by NIB since 1990 and are you currently an Executive Director of NIB having responsibility for the NIB Treasury Division? --- Yes, I am.

- 45 The statement that you prepared which constitutes pages 1 to 26, do you confirm and you adhere to the contents? --- Yes, I do.

You appreciate that this statement will constitute evidence before this Commission? --- Yes, I do.

- 50 In paragraph 2 you deal with the group structure of NIB which is set out in Annexure Lane 1 on page 27 of your bundle? --- Yes.

And you identify the key areas of activity of NIB in paragraph 2.2 through to paragraph 2.8.3 on page 7? --- Yes, I do. I think just one point I would like to make, is that we are 85% owned by the Nedcor Limited. The Nedbank or Nedcor is 100% owned by Nedcor Limited. So we are brother and sister companies and much of the evidence I will give will be similar to what has been said before. We have similar compliance issues and similar people involved in those issues. So I would just like to make that point.

- 55 Thank you. And the key personnel responsible for the various business units are reflected on Lane 2 which is page 28 of your bundle? --- Yes.

- 60 You identified the markets in which NIB operates in paragraph 3 on pages 7 and 8 and you deal with the products in paragraph 4 of your statement? --- Yes, I do.

And is it correct having regard to 4.1.8 that all scrip lending activities are conducted on an agency basis and are non custodial activities? --- Correct.

In paragraph 5 you identify the risk management internal controls and compliance and according to your earlier statement it appears not dissimilar from that adopted by Nedcor Bank? --- Correct.

You identify the major risks in paragraph 5.2 of your statement and in 5.3 you say that NIB's risk management framework makes no distinction between local and foreign elements. --- That is correct.

You limit framework including exchange control limits are identified in paragraph 5.4 and referring to 5.4.2 were there any limit, in terms of limit adjustments or excesses reported in the year 2001? --- No, there were not.

In paragraph 5.5 you deal with the procedures to monitor compliance with limits during 2001? --- Yes, we do.

Can you deal specifically with paragraph 5.5.2? --- Yes, I can. Basically what we are saying here is that everything that we do is loaded onto a source system. I think you must differentiate between source systems and spread sheets. I think where spread sheets are used it could be proprietary to the dealer. However, the source systems and those would be, in the old days those would have been called mainframe systems where all your big deals are loaded up on that system. There is very little way for deals to slip through the cracks, those would be then picked up, all the monitoring committees, the people that are involved in all of these things and it leaves very little scope for any sort of limit excesses or breaches of compliance limits within the organisation. So I think that is the key to our monitoring processes that we use source systems for all deals. In the old days if you had people hiding deals in drawers and that kind of thing, that could have led to bad speeches but that would be a fraudulent activity within our environment and that would be the only way that people could circumvent our internal systems.

In 5.6 you deal generally with the compliance with SARB regulations and in 5.6.2 you identify the procedure for verification of exchange control compliance and its management. According to what you say in 5.6.3, is it correct, that due to the nature of NIB's business, you do not offer, as a service to clients, any CFC accounts. --- Yes. We are not a commercial bank, we do not offer current accounts in local rand currency, so why would we offer, so we would not offer foreign currency accounts which is merely a current account for foreign currency.

In 5.6.4 you identify the documented procedures in place to ensure compliance with the 180 day rule? --- Mm.

And in 5.6.5 again you say the NIB does not offer Vostro accounts to foreign banks since these accounts are mainly the function of a commercial bank? --- Correct.

Regarding ethics and the nature of ethical standards, you deal with that in paragraph 6.1.1 on page 17 of your statements? --- Yes, I do.

And according to paragraph 6.2 are you able to say whether there are any significant differences with the ACI Code? --- No, there are not.

In 6.3 you make a statement regarding ethics of trading in the rand, would you like to add anything to what is contained in 6.3? --- I think we view this as providing a service to our clients and, you know, perhaps why you would hold a long Dollar position is if your clients are continually phoning you up and buying dollars from you, would you not hold a store of dollars in your balances to service those demands. So you know to assume that holding dollars is a speculative activity would be going too far. It might be but it may well be that you know that today everybody is going to be knocking on the door and asking you for dollars. So what you would in fact do is hold a store of dollars and that might be construed as speculative activity by people that are not aware of the motivation. It is all around the motivation for holding the dollars. It is exactly the same thing, it looks like the same thing, your longer dollars, your long dollar position, it looks like you are speculating against the dollar but in fact you may well just be stocking up your larder to provide the services to your clients and as far as NIB is concerned, other banks are clients as well, being an investment bank we are far more focused on the inter-bank and the upper tier of the market. We do not have a lot of retail clients and smaller commercial clients and their demands would be large. But we would be obviously constrained in terms of our stockholdings, and referring to dollars in that case, by the limits, the internal limits, and the Reserve Bank limits which are quite clearly set out.

Thank you.

MR GANTSHO: Mr Lane, thank you for that elaboration and that clarification. You define

speculation in 6.3.2 as betting on the future price of a defined asset. --- That is our definition of it, yes.

I was simply and merely trying to clarify what the purpose is for holding the dollars long. Are you confirming now that it was that the intention was not as stated in 6.3.2? ---

5 That is right. The primary motivation would be to, quite honestly we are highly constrained in terms of the size of the dollar positions that you can hold, unlike perhaps the foreign banks which have much larger balance sheets, they are able to hold quite large dollar positions. Merely by the size and also NIB in particular is quite a smallish bank. That size would not just by its pure size, would not be construed as a speculative kind of position but there is no
10 doubt that a dealer would position himself in such a way that during the course of the day he did not lose money on his position knowing or anticipating the demand for dollars that are going to - so there is a bit of view built into that as well, it is a philosophical debate whether that view is speculation or it is merely stocking up your cupboard for future demand. And it is not always entirely possible to understand exactly what is going through that dealer's mind. I
15 think human nature would probably give you some clue as to what is going through his mind.

Thank you.

MR NAIDU: In 6.4 you deal with the compliance with ethical standards and in 6.4.3 you identify in four sub-paragraphs the measure adopted for implementation. I would like to draw your attention to 6.4.3.1, are you able to comment on what is done to secure the record of
20 these telephonic conversations and are you satisfied that the knowledge that these conversations are recorded and stored is a sufficient deterrent? --- Absolutely yes. It is on stiffer disc, it used to be on tapes before and those discs or tapes are stored in fire proof conditions, so they are only accessible by authorised people.

Regarding the breaches of ethical standards during the year under review, is it your
25 evidence that there were no breaches to your knowledge? --- That is correct. Just perhaps to clarify, NIB is a smallish environment. It is fairly easy to monitor on a one on one basis. It is, unlike the dealing rooms overseas or even some large dealing rooms in South Africa, there could be up to a thousand people in the dealing room. Even the people within the dealing room do not know each other. But in terms of the South African situation, and
30 specifically NIB, every dealer is obviously well known to everybody else and is monitored on an on-going basis in terms of his ethical and other activities.

In paragraph 7 you deal with the position prior and subsequent to the issue of the circulars D341 and 342, and you articulate a view in paragraph 7.3 regarding these circulars and the value of the rand. Would you like to elaborate on that? --- Our view does not differ
35 much from Nedcor's view or Nedbank's view.

Is there anything you would like to add? --- I do not think so.

CHAIRPERSON: Just before we move on, in 7.1 you raise the issue of the rules which have fallen into disuse. Could you just elaborate on that for our purposes? --- Yes, in a previous
40 statement I think that was discussed at length. Basically our approach is, firstly there was no sort of description as to how we should enforce these rules. So the way we used to go about it was the first rule of banking is to know your client and a bit like I described, you have got to know your personnel as well and you have got to know your client and that means nine times out of ten you would have visited that client physically and would have a personal relationship with the dealer on the other side and that goes, I do not want to mention names
45 of particular speculators, famous speculators that were supposed to have been in the South African market in days gone by but if we dealt on behalf of those kind of people, we would know those people personally and that has always been NIB's rule and maybe because we do not have as many clients as some of the other banks do, we are not a commercial bank, we have a very select client base, so I would say that in terms of, I think this is perhaps a
50 slightly strong statement here. As far as we were concerned, if we were approached out of the blue by a client that we did not know personally and did not have a strong feeling that they had a firm and ascertainable activities to hedge or to conduct in South Africa and it made no sense for them to be involved in the South African market, we would not have dealt with those kind of people. So I would say that perhaps the written enforcement of this ruling
55 had fallen by the wayside but your banking activities and the way you conduct your business would ensure that it was highly unlikely that people that had no business to be involved in South Africa and in South African rand were able to conduct any business through a South African bank and specifically through NIB.

Are you saying because you knew your counter parties, you accepted that they
60 would comply with the requirements of the underlying transaction? --- Yes, we probably

started taking it, we assumed that they would comply, yes.

So you were not calling for the written proof? --- No, we were not at that stage. That was only once we met under the auspices of the ACI, we discussed, all of the authorised dealers in South Africa discussed how we were in fact going to give teeth to this particular ruling and we came up with this proposal which we then submitted to the Reserve Bank and they felt that that would mean that if we did this we would comply with the spirit and the wording of the law, of the regulation.

When you talk about the proposal, are you referring in particular to that authorised dealer statement? --- The current procedure that we are following.

10 Yes, that you set out in that 16 October .. (intervenes) --- Correct.

MS QUNTA: Mr Lane, are you able to say then that the statement I referred to earlier that the governor said that it may be that people who were speculating in the market, in other words speculating in such a manner that they violated exchange control which contributed to the depreciation of the rand or the volatility? --- Mm.

15 That as a result of 13 October they exited the market because they could no longer continue to violate exchange control. Are you able to state that that statement is not correct or that view is not correct? --- Well you know the empirical evidence seems to suggest that that in fact is the case but I visited London soon thereafter and I visited a couple of the large banks that were involved and, yes, I think that they perhaps felt that they did not want to expose themselves to something that could be construed as being speculation. You know it might just have been a sort of a cautionary kind of - bearing in mind that I think everybody said that it is not totally clear what exactly you could do and you could not do and I know that banks overseas take their regular tree(?) and as they do in South Africa their compliance functions very very seriously, you know, and it could lead to sort of legal cases and damages and all sorts of things and I think they thought well discretion is a better part of valour here and perhaps for the moment until we see what happens we better withdraw and that in itself then became a self fulfilling prophecy because the liquidity dried up and they did not want to be involved in a market which had no liquidity because that meant they could be trapped in a situation which they could not liquidate and there may well have been an underlying transaction which they were trying to hedge and so it is, the one thing led to the other and then it became a *fait accompli*, it became a *de facto* situation, you know, so I am not sure if they were in fact speculating to any great extent. You know it is this interpretation thing again which I discussed earlier but they may just have felt that South Africa is no longer a place, bearing in mind these very onerous regulations, that I want to be involved in any more. It might have been more of a philosophical kind of stance taken based on the onerous regulatory environment that they would be expected to operate in.

20 MR NAIDU: Mr Lane, in 7.4 you deal with the impact of trades with corporates and non-resident banks as a result of the circulars. Is there anything that you would like to add to what is contained here or are you content with what is stated in 7.4.1 to 7.4.6? --- I am happy with what is in this document.

25 Regarding the impact on the bank results and activities, you have set out in Annexure Lane 4 a schedule reflecting the gross profits a month for each of the months from 1 January to December and in 8.2 you speak of the broad impact of depreciation in rand on NIB? --- Yes, you know I think short term profits and you will see from that schedule that we were profitable over that period. You could say we had a well stocked larder, I mean, but the longer term implications for NIB are dramatically negative. We now bank in international terms, when we measure our balance sheet in dollars, we now bank - I am not sure of the exact depreciation, but I can come back on it, but we now bank which is 40% smaller in dollar terms than it was prior to this event. So this event holds no long term advantage to NIB whatsoever or to South Africa for that matter. And that would have been the kind, and I can vouch for the chief foreign exchange dealers and the anguish really that these people experience watching this happening. It is a very very difficult situation to be in and you know their own personal wealth is also diminishing at a rapid rate. So short term gain or just to protect yourself through some of the position taking that might have been taken to facilitate the market, making .. (indistinct) pale in insignificance around actually what has happened to NIB in particular going forward and for the Commission's edification, what that means is our lines, our trading capability with overseas banks is set according to the size of our balance sheet in dollar terms and that means that our trading line going forward now are severely diminished and by implication if you add that all together South Africa's trading lines are diminished as a consequence.

In paragraph 8.3 you state that during the period under review it can be described as a period that was unusually volatile and the market moves were capitalised by unusual swings and volatilities. There was an increase in your bid offer spreads and you set out what you regard as these "hot trading days" from 10 January to 21 December under 8.3.1? ---

5 Yes, we do yes, they are much the same as for Nedcor.

And you also documented in Lane 5 the market views on the desk head regarding these hot trading days? --- Yes.

In paragraph 9 you deal generally with transactions which could affect the rand and in 9.2 you say that to your knowledge no clients exceeded their credit limits during 2001 with the specific objective of speculating in the rand. --- That is correct.

And identify the reasons for excesses in 9.2.1 to 9.2.7. Is there anything that you would like to add to what is contained there? --- No, these are purely technical kind of breaches that would happen on a day to day kind of basis, well not day to day but would happen from time to time.

15 And is it correct that during the period under question NIB made only one rand dominated loan in respect of which prior approval had to be obtained from the South African Reserve Bank? --- That is correct.

MR GANTSHO: Sorry, Mr Lane, can you give an indication as to when during the year that loan was made, I just want to establish if it could have had an impact in the events? --- I personally am not aware of the date of the loan, I would ... (intervenes)

20 Is this related to the aircraft .. (intervenes) --- Yes, it would have been done in an area totally separate from the Treasury and it would have been evidence gathered from this particular individual. Sorry, I cannot answer that question, I will have to come back to you on that one.

25 CHAIRPERSON: Telephone during tea if possible and you can just place it on record, the amount and the date. --- Right.

Let us adjourn for 15 minutes.

PROCEEDINGS ADJOURN:

PROCEEDINGS RESUMEPETER LANE: s.u.o.CHAIRPERSON: Shall we continue? Mr Naidoo, where are we?

5 EXAMINATION BY MR NAIDU (continued): Paragraph 9.4 on page 25. You make the point that there were no internal limit adjustments in the period under review and no limit excesses. --- That is correct.

Paragraph 9.5 save for the minor deviations from administrative duties and procedures prescribed in the rulings, you are not aware of any material breaches of exchange control either in any organisation or in respect of your client? --- I am not.

10 And you identify in the two sub-paragraphs 9.5.1.1 and 9.5.1.2 the examples of these deviations. --- That is correct.

Are you aware of any illegal or any unethical transactions within the business of your bank? --- No, I am not.

15 And in the course of the operations of the bank, to your knowledge, is there any person or persons who might have made an improper gain or improperly avoided loss from the rapid depreciation of the rand? --- No, I am not aware of anybody.

Does this apply both in relation to transactions by non-residents? --- Correct.

20 You make certain recommendations in paragraph 10 concerning the administration of exchange control. Would you like to state that? --- I think the gist of what we are saying here is that in some cases provisions in the Circulars have not been included in the rulings and there is a possibility that this could give rise to confusion. I think that is our main recommendation is perhaps try and ensure that there is total clarity and understanding on the part of the banks as to what they are expected to do in certain cases.

25 Finally Mr Lane in the questionnaire submitted to your bank, you were invited to make any general comments which might be of assistance to the Commission. Is there anything that you would like to present? --- I tried to do that in the course of my representation here. So unless there .. (intervenes)

30 You have nothing to add? --- I have nothing to add to it except to say that I think our intension to try and assist this Commission in any way possible and I want to reiterate they can rely on our assistance in that regard.

Have you managed to get the information that you were requested by the Chairman? --- Yes, I did. I have got those dates. The Reserve Bank approval for this particular loan was granted on 29 August 2001 and I think the deal went through towards, at the end of September 2001. The amount although material, I would not really like to mention, 35 I think it would allow perhaps people to identify the client involved, and although the amount was not insignificant, it was not material in the light of this Commission. I do not know if there is any more questions on that particular deal.

40 CHAIRPERSON: Perhaps what you can do, Mr Lang, is to give us the amount in confidence so that it is not given in public so at least that we are aware of it and we can make an assessment in that regard. --- I will be happy to do that.

MR NAIDU: Thank you, Mr Chairman.

CHAIRPERSON: Mr Subel, do you want to re-examine in any way?

MR SUBEL: No further questions.

CHAIRPERSON: Questions?

45 MS QUNTA: I just have one question. You indicated here that there was confusion in the market before the Exchange Control Rulings or Regulations. Was that the case with NIB too? --- My mind standing is that there was no requirement to receive documentation from offshore counter party banks around their .. to receive documentation around their commitments in South Africa. I think we felt that they were doing sufficient in terms of 50 knowing the client, having spoken to the clients on an ongoing kind of basis and bearing in mind, I am not talking about corporates here. Corporates have always been obliged to supply documentation although some corporates are given permission to supply their documentation just to prove that they have certain dispensations. So we are not talking about corporates here. We are talking about offshore banks, counter party banks, and we 55 felt that we were complying because we had very intimate knowledge of type of deals these clients were doing but my understanding is that there was no former requirement until the meeting in October to actually get written confirmation that there permanent understandable commitments that these counter party banks were hedging.

60 Was that the only area that you were confused about as NIB or were there other areas? --- Look minor interpretation issues would crop up from time to time. We had had a

number of Reserve Bank inspections from the Exchange Control Department. They had always given us a top rating in terms of our exchange control compliance and our exchange control person is an exchange control officer and he used to work for the Central Bank. So we believe that our interpretations were correct. But as with any regulations perhaps people could construed and slightly differently from time to time. But we never felt that we were not complying with the spirit and the wording of the law, of the regulation.

At any stage prior to 30 October, did you make an attempt to clarify with the Reserve Bank if there were areas that you were not clear on because we have heard evidence from the Reserve Bank on Monday that the duty in the event of confusion or uncertainty, the duty is upon authorised dealers to seek clarification from the Reserve Bank. Have you done that at any stage? --- We would meet with the Reserve Bank on a regular basis. You know the kind of philosophy that you know your client. We also we know the people and the individuals at the Reserve Bank quite well and we may not have made formal written sort of questions or statements to them but we certainly would have had ongoing contact with them and specifically our exchange control officer within the organisation would have ongoing interaction with them and would have clarified in his own mind exactly how he should be implementing these rules and regulations and so that we would not fall foul of any contraventions and perhaps audits that might be conducted both internally/externally and by the Reserve Bank itself. So we felt that we were doing all we could. We feel that we are doing all we can to in fact comply with these regulations and we had not been singled out in any way whatsoever in terms of Reserve Bank audits by auditors in any way that we are not complying with these regulations.

No further questions.

MR GANTSHO: No questions.

CHAIRPERSON: No further questions. Thank you, Mr Lane. You may stand down. --- Thank you.

NO FURTHER QUESTIONS

MR NAIDU: The next witness will be Mr Dennis Dykes who will present evidence as Chief Economist for the Nedcor Group.

CHAIRPERSON: Yes.

DENNIS MICHAEL DYKES: d.s.s.

CHAIRPERSON: Thank you, Mr Dykes. You may be seated.

EXAMINATION BY MR NAIDU: Mr Dykes, are you employed by the Nedcor Group as Chief Economist? --- That is correct.

And as such you are responsible for the economic unity within the Nedcor Group. --- Correct.

And have you been so employed since 1 December 1983? --- Yes, I have grown within the Group since 1983 and I had this group functions since 1994.

You set out your qualifications in paragraph 1.2 of your statement. --- Correct.

And the statement that you have prepared, do you confirm and adhere to the contents of this statement? --- Yes, I do.

And do you appreciate that this statement constitutes evidence before this Commission? --- I do.

You have in paragraph 2 identified the factors influencing the rapid depreciation of the rand during 2001. Would you like to discuss that? --- Yes, thank you. It is my opinion certainly that that you cannot pinpoint anyone particular transaction or group of transactions which helped the rand's decline. It really is a combination of events which pushed the currency down over a period of time and if you go back to 1996 in actual fact the currency has had strong periods of weakness. I have divided this discussion under various headings - Structural, Technical conditions, Sentiment conditions and I am happy to discuss those but my basic prima is that without the technical conditions, the structural conditions, would not have pushed the currency down as quickly as has occurred over a longer period of time. Now without the sentiment conditions, the technical conditions would not have had the same sort of influence as they did particularly coming through in December. But I will just go briefly into some of the thoughts. Economists do tend to concentrate on the structural side rather than looking at day to day volatility in markets and on the structural side certainly we would identify a certain number of factors. For example the opening up of the economy since 1994 and even earlier than that. So we started reducing trade tariffs which in the absence of full flexibility of wages for example often leads to the currency weakness. So over a time one would expect the certain amount of weaknesses throughout the back factor. Since 1995 the

Reserve Bank on instructions of the Treasury Department has been relaxing exchange controls and a large amount of money has left the country as a result of that. Something R120 billion we estimate but it is not something that is confirmable because that is held by the Reserve Bank.

5 CHAIRPERSON: Is that since 1995? --- Yes, that is right. And here I am talking about the so-called assets swaps and individual announcers clearly that in other areas for example relaxation on companies, *ad hoc* type of arrangement with companies allowing them to invest abroad. So considerable sums have gone out but I think it is also fair to say that considerable sums have also come in more than compensating. I would actually estimate
10 those outflows.

MR NAIDU: So is this the net amount the 120 billion? --- No, it is not the net amount. That would be the gross amount and as I say to some extent it is speculation on my part, it might have actually increased quite a bit over the last year or so for example. The keypoint about exchange control is that the market centre anticipate that it will continue to occur and
15 consequently people never really know the real value of the currency and there is continual speculation as to where it might go and investors, both foreign and domestic, are likely to take into account investment decisions and not have confidence in the case of foreign investors that their assets might not be (indistinct) over time. So the existence of exchange control is in itself detrimental to a currency but the relaxation also does tend to put a currency
20 under pressure at the time. Those are the very basic structural factors. I guess one could also include in that a fairly high level of inflation over time you would expect that to erode the currency and that has occurred but I hastened to add that since 1996 we deviated far beyond what you would have expected as a result of high inflation in South Africa versus other countries.

25 On the technical side this include a number of factors including the absence of large dollar inflows during the course of last year and even the threat of large inflows coming through the foreign exchange market itself as a result of the reduction of the Net Open Forward Position by the Reserve Bank again on instruction from Treasury. Also the removal of any threat from intervention by the Reserve Bank in the market also would tend to be a bit of a technical
30 factor in the sense that anyone speculating in the currency would maybe gain some comfort from the fact that no one was going to come in, an individual position.

CHAIRPERSON: So 2.6.2 should really read the absence of the threat of intervention by the Reserve Bank? --- Correct.

Yes. --- There is a lot of argument as to whether a central bank should or should
35 not intervene in markets. In our case obviously the authorities do not have huge resources to intervene in the market but it is true that if authorities are feeling that they are not going to be in the market, that it might lead to some comfort and consequently in bold and perhaps speculative (indistinct).

The further factor was introduced in the last quarter of the year with the 14 October meeting.
40 The circular came somewhat later. So my apology for that. I think it has been mentioned earlier on, clearly market players withdrew from the market even if they felt they were doing things incorrectly. In the world of international finance if there are any complications in the market, you tend to find participants withdrawing from that market. For example Germany a couple of decades ago was introduced, was withholding tax that actually led to a fall in
45 currency. So any complication both tend to increase the compliance costs and that tend to lead to some withdrawal of activity from that market and that is what appears to have occurred in the intervening weeks, subsequent weeks to that. I think it is also fair to say that fin market conditions could lead to a strong appreciation as depreciation. It does not necessarily have to lead to a depreciation of the currency but taken in conjunction with the
50 other factors which I have mentioned and which I am going to mention on the sentiment side, it helped to lead to a very strong depreciation of the currency rather than any sort of appreciation.

The other factor which was introduced I think very intentionally was that in December 2001 we saw big portfolio outflows as a result of the late passing of regulations by the authorities
55 concerning private fund managers offshore allowances which have been announced in the budget and which the institutions only or rather the current fund managers only really got the go ahead late in October and then had to comply with the regulations, then were forced to actually withdraw this money during the course of December 2001 for having opportunity of withdrawing that money.

60 Who published those regulations? --- It is published by the Reserve Bank but it

would have been on instruction from the Finance Department.

And when you talk about mass portfolio outflows even if you can just give us an intimation of the .. or an estimate, what do you think, what is your feeling was involved here?

--- It is very very difficult to say but it would have extended to billions of rands and I think the
5 keypoint there is under normal conditions and over a period of time, that would not have been a problem in the market such as the rand market but in December when the currency was already falling, it must have been one of the factors which added a bit of timber to the fire.

Yes. --- The other factor which I have listed under technical Factors, was the delay
10 in the privatisation process. No fault of government obviously. It was more as a result of what was happening in international markets but nevertheless the fact that there was not proceeds from that privatisation process or not forthcoming and would not be forthcoming until later, hopefully this year, meant that again the market was more jittery about the rand.

So those factors effectively did lead to some weakness. It would have by themselves
15 actually led to some weakness but I think the important thing ... sorry I should just maybe quickly discuss the Net Open Forward Position. Again the fact that the Net Open Forward Position was in a state of being eliminated. It did tend to me that any large dollar inflows into the market would be withdrawn from the market or retired from the market by the authorities and consequently reduced the opportunity of the currency fluctuating upwards from time to time. So if you look at a graph of the rand, certainly since the concerted attempt of getting rid of the Net Open Forward Position, they are both in the same sort of line. Again I think it is if you are looking at speculative elements in the market, it would tend to give comfort once again that a large inflow would not lead to a significant appreciation of the currency and consequently lead to a loss on that particular dealer's account.

25 MR NAIDU: Mr Dykes, before you proceed just your comment on the asset swap mechanism and the effect in your view it could have had. --- Obviously the asset swap mechanism formed part of the exchange control over a long period of time where the institutions were allowed to actually take money out. That was abolished earlier in the year. The new regulations came into position but in this context I do not think it was a significant
30 (indistinct).

If you could deal with the sentiment factors, paragraph 2.9. --- Yes, given that limit of any sort of outside potential in the market, sentiment factors did play a significant role during the course of last year and I have listed a number of things here. It goes back over a period of time. For example in 1996 President Mandela's health did also push in a bit of a
35 currency crisis. In 1998 the emerging market contagion also pushed a currency crisis and this time around we have the similar sort of set of factors which impacted on the currency. I think Zimbabwe is probably the most important of those being the closest to home and being a very negative international issue that again a lot of prominence during the course of last year and it indeed still retains a fair amount of prominence. I have divided into two factors
40 here. Initially I think concerns, and I am talking really in discussions with foreign investors which I do have from time to time. The concerns were the direct impact might have on the economy but those are relatively small but the concerns quickly turned during the course of last year to thoughts of some sort of contagion, political contagion to the South African case which I have to say that, you know, that I do not particularly agree with and we tried to lay
45 (indistinct) on that score but nevertheless it did come up quite often in discussions with foreign bankers as well as potential foreign investors.

So Zimbabwe unfortunately gained more and more prominence and particularly during the course of December it gained a lot of prominence in the press I think as a result of other news and consequently we almost on a daily basis during the course of December had some
50 or other report about Zimbabwe or our response or some politicians response to the Zimbabwe situation and regrettably that did actually play on the market.

I think one thing one has to stress when I am talking about the sentiment factors as well, if you put yourself in the line of a dealer, if something flashes on the screen, they have got to react in one of three ways. They either just hold their position, they sell the currency or they
55 buy currency and if there is news on Zimbabwe that flashes on the screen, the typical response would be first of all sell and then ask questions later and consequently something like Zimbabwe appearing on the screen, very often must have actually added to that down momentum during the course of December in particular.

Mr Dykes, one of the witnesses that testified before this Commission, expressed the
60 view that the Zimbabwe issue had (indistinct) just drives 2001 in the early stages of 2001.

So it was an issue that was there all the time. What is your comment in that regard when you say that this had an impact on the results in relation to the end of the year? — Yes, look certainly the Zimbabwe issue has been alive since the referendum which occurred quite some time ago but, and it is also true to say that the rand has actually been under some
5 pressure over a fairly long period of time. I think it gained momentum, the story gained momentum towards the end of last year with the approaching presidential elections with obviously our government's interaction with Zimbabwe trying to actually resolve these issues and trying to play the middle person in some senses. So it gained a lot more prominence that we had in the early part of 2001. And then I think once again you have to then look at
10 the background and the background was very thin market conditions. So what might not have had such a significant effect early in the year, certainly had a major effect later in the year because of the market conditions.

If I can move on to perhaps another sentiment factor, the emerging markets difficulties. Emerging markets certainly once again came under the spotlight in 2001. The situation in
15 Argentina deteriorated during the course of the year. We had problems in Turkey and Indonesia. We found also that related to the risk aversion issue, we also found that the Nasdaq for example in the States which is more of a speculative type of investment, came under significant pressure for the greater part of the year although I should add immediately that that was not the case in the fourth quarter of last year. That also came under pressure
20 highlighting investors unease with, if I can put it, second grade type of market activity and there was definitely a flight to quality. It had been stated and remains the case that the rand tends to act as a bit of a proxy for emerging market activity because it tried to certainly the October 14 measures was very very liquid currency and consequently people have actually reduced their exposure by reducing .. to emerging markets by reducing exposure to South
25 Africa in the first instance which may have been a motivation for trying to actually reduce that type of activity in those measures. That could have been one of the motivations.

But it is true to say that you cannot just pinpoint emerging market difficulties and say that is why the rand fell because by the fourth quarter of the year already the currencies, most emerging market currencies were starting to recover in particular for example the Brazilian
30 real. Neighbouring on Argentina was already appreciating rising in the fourth quarter despite the time when the currency was actually plunging. So it is a background factor. It is something which dealers necessarily refer to from time to time but nevertheless it cannot be used as a factor to explain why the currency, certainly alone cannot be used as a reason why the currency took such a big knock in the fourth quarter of last year in particular.

35 And what is also true is that if you look at South Africa's risk rating as measured by the risk premium in our dollar denominated bonds, that hardly moved through this whole period, through the September 11 crisis; through emerging market difficulties. In other words South Africa continued to be rated very well by foreign bond investors in particular. Ironically we also during this period of rand crisis had a ratings upgrade which underlined that factor. So
40 that often is cited but certainly one could not pinpoint that time as being the major reason.

And I speak of speculative actions in the market. Sorry perhaps I should just conclude that particular part of the commentary by saying that really just a combination of factors seemed to hit us during the course of the final months of last year and when the currency starts gaining downward momentum, it either basically has to move to hedge themselves against
45 that. Importers were hedging themselves against that. Exporters were tending to hold proceeds for longer, for as long as they could under regulations. Individuals were clearly also trying to get money out during the course of December and subsequent months as a result of the rand's depreciation. So it changed everyone's behaviour and it will be very difficult to pinpoint who was behaving with what motivation during that period.

50 Proceed with Speculative Actions. — Perhaps I can just read part of this. Market speculation we feel is a normal market function. It often takes the form of arbitrage. People anticipating what others might actually do and in that way it acts as a smooth functioning of the market. It actually provides depth to the market.

I think in a very broad view of what constitutes speculative actions in 2.13.2 and said that any
55 action designed to benefit from a view of the currency's future direction where the outcome of course is always uncertain. You never know where it is going. It tends to be a speculative action. An exporter not repatriating the proceeds immediately in a sense is speculating on the currency. Importers covering forward might of course just be heading for normal hedging activities but also might have a view on the currency, it has to take a view as to whether it is
60 worthwhile or not to actually go ahead with that and clearly traders take short positions in

currencies based on their view of what might actually happen. But even individuals taking out allowance under the regulations, I guess could be included in a very broad speculative definition although again as was the case with importers, it could be seen as a hedging of one's investment risk.

5 CHAIRPERSON: In other words what you are saying is whatever name one gives it, the truth is that everybody involved took a view that the rand was going to decline? --- Correct.

And every importer accelerated and every exporter delayed the transaction and everyone who could afford the 750 000 allowance, that all would contribute to a continuing decline. Is that really what you are saying? --- Absolutely. We do state that speculative
10 actions could include illegal transactions in breach of the Exchange Control Regulations or Laws but that we obviously would not know the complicity of such actions. So we cannot really give a good feel for what might have been happening during the period.

MR NAIDU: Mr Dykes, what is your view regarding the entry activity in regard to non-residents in the rand market? --- The activity of foreigners in the market obviously would
15 normally be welcomed. It adds to liquidity. It adds to a greater number of players. We do state here that obviously the more significant number of players that you have in the market, the less the chance there is of one big player influencing direction on any particular given name.

So correspondently the withdrawal of people from the market makes for a very dangerous
20 market and a very jittery market as has been referred to by one of my colleagues earlier on.

Do you have recommendations regarding the regulation of the rand market? --- We do feel that in our general opinion that exchange control should be eliminated. They do create distortions. I have referred to one or two already. They do distort fixed investments decisions and at the moment uncertainty, my experience in the course of last year was that
25 foreigners were often citing the currency weakness as a delaying factor for bringing forward investment decisions and they did tie that up to exchange control regulations. We do appreciate that the government does have a dilemma that if we abolish them immediately and totally that there could be far reaching consequences that markets could actually go erratically in a short space of time; that it could lead to social and political problems and that
30 well it is (indistinct) like myself that suggest that it would be a good experiment. Obviously one can appreciate the reluctance to undertake such a dramatic sort of experiment and consequently bodies such as the IMF are fairly reluctant for a country to take those sort of steps as well.

CHAIRPERSON: We know that IMF agrees that it must be gradualist? --- A gradual
35 approach. Obviously the existence of the exchange control, is an ideal and the path to get rid of it, is going to be with all sorts of problems and obstacles. As far as the other regulations are concerned, I think my colleagues have covered a number of those aspects.

MR NAIDU: In paragraph 5 you expressed your views regarding certain of these "Hot trading days" by Nedcor Bank. Is there anything that you would like to add to this? --- I think
40 the key here is that economists, you know, obviously trade is going to move and markets and economists tend to look for reasons at the time. So I have often actually just said here "no particular comment" because there is no particular factor why you would have expected the currency to move in the way that it did on a particular day. On certain days, and I have listed them, there were particular features which you could actually associate with particular
45 statements and things which led to a currency coming under some sort of pressure. But as I said a little bit earlier on, economists tend to look at a broad direction and for reasons for that rather than actually concentrating on particular days and why they should actually be (indistinct). Indeed on 29 November we had the ratings upgrade by (indistinct) and I recall being on television saying that I thought it should be positive for the rand. That was at lunch
50 time and by the end of the day the currency was significantly lower. So that is what can take

Thank you, Mr Chairman.

CHAIRPERSON: Mr Subel, re-examination?

MR SUBEL: No questions.

CHAIRPERSON: Any questions by the commissioners?

55 MS QUNTA: Mr Dykes, you have mentioned certain factors. Are you able to exclude the effect of transactions in terms of our terms of reference? Are you able to state to the commission that there were no transactions that could have had an impact on the depreciation of the rand? --- Do you mean as far as Nedcor is concerned or as far as the .. (intervenes)

60 Well, generally. I am not talking about Nedcor. --- No, I would not make that

statement at all. I think clearly big transactions could have influence the direction of the currency. Again one has to say would those transactions have in the first place occur and secondly had that sort of effect, if you did not have the background factors that I have put forward.

5 I am coming to some of those backgrounds and this is the question I have also asked from economists that gave evidence in the first week who mentioned Zimbabwe, the president's views on Aids and a whole range of macro economic factors and perhaps because I am not a trader, it is a bit reflecting for me because if, let us take the crisis in Zimbabwe. That crisis had been with us for the last two/three years and in fact I think when
10 the Commission sit imparted just before the election, the levels violence in Zimbabwe increased quite dramatically and in that week the rand strengthened. So my question to you is: is the Zimbabwean factor for example, are you able to say categorically that this is how it affect the sentiments of the people who sit and press the button and make the price of the rand in view of the fact that there does not seem to be a logic to that argument? --- Well, I
15 would say that there is a logic to the argument in the sense that Zimbabwe has been with us over that whole period of time and the currency has come under a lot of pressure. As I explained a little bit earlier on in the dealer's reacting is one in three ways and clearly something negative on Zimbabwe would be interpreted as a negative as far as the South African situation is concerned. In my dealings with foreign investors and potential foreign
20 investors, their view has often been expressed to me and we tried to put them right on it, but the view has often been expressed well if it is happening in Zimbabwe, then how can we be sure of our long term property rights in South Africa. Again, you know, that is clearly not something we would actually agree with. We obviously know the local situation is not better than our foreign investors do, but one must put yourself in their shoes and see that they tend
25 to look at Africa as one a modernist type of entity and Zimbabwe obviously being very close to South Africa, starting off in a strong hope situation as well, it clearly makes them uneasy. So not only would dealers perhaps have reacted in that way but you might have, and I am fairly certain that this has happened that we have had a delay at least as a result of those sort of factors.

30 You see when I say lack of logic, I am not arguing with you, I am not an economist. I am trying to understand that if earlier this year just before the election, the Zimbabwean crisis worsened. People, you know, I think there was the hope that the elections would be relatively free of violence, but it was not. During that week in fact it had no impact on the rand. In fact the rand strengthened, for two days it strengthened. I am saying to you, how do
35 you factor the fact that the Zimbabwean crisis into that because Zimbabwe was worsened. So if what you are saying that the Zimbabwean crisis has an impact on the depreciation, on that day the crisis worsened but it did not affect the rand. In fact the rand appreciated. --- I think what you are saying is absolutely correct. But my major thesis here is that no one factor impacts on the rand and what has happened subsequent to December is of course that
40 liquidity has improved in the markets. So that has been a factor which has been removed and on any given day you can have other factors which impact on the market which might be more persuasive. For example you might have a big exporter who is bringing proceeds back and one or two big transactions move the currency in a way which actually if you look at it on the day, you would have thought would have been positive. I mentioned the fact that .. or
45 negative for the currency. I mentioned the fact that we had the SMP upgrade. Again logic would have demanded, and I think any logic a person would say well, that should actually be positive because it means that more people can invest in South Africa with confidence but on the day the currency actually fell and obviously there was another factor which was impacted.

50 So are you suggesting, Mr Dykes, that economists may not always or their views may not always be logical or the market may not be logical? --- The market certainly. Pardon? --- The market certainly.

I am prepared to accept that. This is a follow-up to my question, the date there, because you appreciate that the reason why I am asking these questions is that our focus, the macro economic factors, I think they are useful as a background though, you know, as
55 you have indicated, they are not precise. You cannot pinpoint but the focus of the Commission on transactions that occurred in the course of 2001, now you have got a list here of the days and you have given well, some continued fallout from October 14 and all those seemed to be macro economic things which are the background. But are you able to say, and I ask you the same question, on these days would you exclude the fact that there
60 may have been transactions which may have impacted on the movement of the rand on

those particular days? --- No, I certainly would not exclude that and you know, just maybe to elaborate a little bit. For example on 21 December there was a very large exporter that came into the market to repatriate proceeds and that led to a significant strengthening in the currency. I think it was the 21st. But you know the currency made its first initial
5 improvement, there was a large order which was one particular exporter that had come into the market. So no individual transactions can be large and they can actually move the market in ways that you would not otherwise have expected.

Thank you. I have no further questions.

CHAIRPERSON: Any further questions?

10 NO FURTHER QUESTIONS BY ANY OF THE PARTIES

CHAIRPERSON: Thank you, Mr Dykes. You may be excused.

NO FURTHER QUESTIONS

CHAIRPERSON: That concludes today's proceedings and we will start tomorrow. Who is tomorrow again? Just remind me which bank is it?

15 MR NAIDU: First Rand.

CHAIRPERSON: First Rand. We will adjourn until 10:00 tomorrow.

PROCEEDINGS ADJOURN