PROCEEDINGS RESUME ON 7 MARCH 2002

CHAIRPERSON: Morning ladies and gentlemen. This is the Thursday morning session of the Commission. Our witness today is Mr Patrick de Villiers. Mr De Villiers could you read your full names onto the record, please?

PATRICK DE VILLIERS: d.s.s.

CHAIRPERSON: You may be seated, Mr De Villiers. Mr Brooks?

MR BROOKS: Mr Commissioner, just before we commence with Mr De Villiers's evidence, just some homework for the record. You will recall that Mr Gouws undertook to provide further slides.

CHAIRPERSON: Yes.

MR BROOKS: Those slides have been provided and I have inserted it in your bundles, Mr Commissioner. If we could insert them in the record at pages 120A, which is diagram 6A, 125a which is a new diagram 15, 125b which is a new diagram 15a and 128a which, well it really has two diagrams 21a. So those are the inserts into the bundles into the exhibit bundle.

CHAIRPERSON: Yes. Mr Van der Linde, I see you are here with some colleagues. Would you just place your name on record?

MR VAN DER LINDE: Thank you, Mr Chairman. My name is W H G van der Linde. I am from the Johannesburg Bar. I represent Investec. With me are Mr T Truman and we are instructed by Mr Jeffrey Krom from Deneys Reitz.

CHAIRPERSON: Thank you. Alright.

MR BROOKS: Mr Commissioner, just for the benefit of those who were not here yesterday, if we could call them the cellphone brigade, if we could please once again ask everybody or remind everybody to put off their cellphones.

CHAIRPERSON: Yes, your optimism continues to interest me.

MS QUNTA: Can I just ask a question, Mr Chair? My understanding is that this is for want of a better word an expert witness. Are you here just on a watching brief or when you say you are here to represent Investec, what exactly do you mean?

MR VAN DER LINDE: Mr Commissioner, Investec has an interest in these proceedings and it has resolved to employ legal representatives to protect its interest and that explains my presence here. I am not here representing this particular witness.

MS QUNTA: Okay, that is fine.

CHAIRPERSON: Shall we start?

MR BROOKS: Yes, Mr De Villiers is the global head of the Foreign Exchange Trading Room at Investec and he will be giving evidence in regard to trading in the financial markets.

CHAIRPERSON: Yes.

MR BROOKS: Mr Commissioner, you will find his CV at page 225 of the exhibit bundle.

EXAMINATION BY MR BROOKS: Mr De Villiers, could you just take us through your CV very briefly please? --- Alright. I will start with my formal education which I completed in 1994 at the University of the Witwatersrand where I completed a Master of Science Degree in Physics. I joined Investec Bank early in 1995 as part of their graduate development programme. Shortly thereafter I moved on to the Foreign Exchange Desk and concentrating on foreign exchange arbitress and ethic structure products. In 1998 I was made responsible for all foreign exchange trading within Investec Bank South Africa. I am now currently in my eighth year with the Investec Group where I currently hold the position of global head of foreign exchange trading and my responsibilities include three trading desks - one in Johannesburg, one in London and one in New York.

Thank you. Mr Commissioner, Mr De Villiers's evidence will relate to slides which you will find at page 226 and further in the bundles. There is not a witness statement but he will give evidence with reference to his slides.

CHAIRPERSON: Fine we understand that.

MR BROOKS: Mr De Villiers? --- Thank you. Starting with slide 226. What I endeavour to do during my presentation is provide a brief overview of trading rooms within banks why banks require trading rooms. I will then move on to the global foreign exchange market with some reference to the South African Foreign Exchange market and I will conclude the presentation with a discussion on regulations and controls in the South African exchange market.

Moving on to slide 227 - I set the tone of my presentation with the following quotation "A primary purpose of the financial services industry is the management or mitigation of financial risk".

Slide 228 I list three population misconceptions with regarding to financial institutions and the financial markets. The first financial institutions take or seek risks. Financial institutions do not actively seek risks. They endeavour to manage risks associated with prior transactions. The second risk is an objective notion. Risk is a highly subject of notion and I will give the example of banking in China. Banks that operate out of Asia might be very comfortable with doing the business in China as a country. However if you compare and had to ask CEO's of South African banks, they might not be as comfortable because of their belief of China as a country risk. Expected returns which is the third misconception, expected excess returns are proportional to the risks undertaken. Risk alone does not always ensure profitability for a bank. Trading desks that are strictly proprietary with no customer flow over the long run are not highly successful. Banks managed the risks that clients provide through their services and we find that it is necessary for all trading rooms to have a substantial amount of customer or what we call customer business and customer flow to ensure long sustained profitability.

Slide 229, what are banks rationale for trading rooms?

Well, firstly their operating philosophy would be to provide a comprehensive, local and international offering to their client base; to focus on ..... products and services and to do this, they would need to provide liquidity in a wide range of products and services that they offer. They would need to effectively manage the risk associated with client transactions and they therefore need a mechanism that transfers client exposure and risk onto the larger financial market. And this is exactly what a trading room does. It provides a conduit for the bank to pass it to risk associated with these client transactions onto the larger financial market. To expand a little bit more on that, a bank might do a particular transaction with a counterparty that it is not comfortable with. It is not comfortable with the size of the risk associated with the transaction. It then goes into the financial markets and seeks another counterparty or financial institution that may have an opposite position that it can sell this risk to.

Moving on to slide 230 - how the trading room is set up and what product it traded. I have listed a group of five basic core areas of any trading room. This is currently how Investec Group is set up and many other international banks but it may vary from bank to bank depending on the decision of management. I use the term derivatives quite frequently on the slide and I would just like to expand on the meaning of derivatives. A derivative in the financial markets is a general term for an instrument that, a financial instrument that is traded through an exchange or custom made and traded over, what we referred to as over the counter between another counterparty. The prices of these derivatives are derived and hence the name from an underlying asset or movement in the asset. If we move on to the equity derivative business, the equity derivative desk would most probably be involved in equity and index derivatives. They would be involved in the buying or selling of equity or stocks and provide hedges on an index. Warrants .. (intervenes)

What do you mean by a hedge on an index? Could you explain to us what does that mean? --- An index is obviously a measurement of the performance of a particular stock exchange or group of shares. A lot of fund managers are measured against .. their performance is measured against performance of the overall sector or a particular index. So it might be in the interest of a fund manager for instance to after he has had a substantial return on the investments that he has made, what we call lock away that investment and he would need to speak to somebody n an equity derivative area to be able to hedge any exposure he has to the equity market thereafter. So they provide hedges and trading instruments on the equity and stock markets.

Okay. --- Warrants are effectively optionality contracts based on the equity and stock markets. The second area are the commodity trading desk. The most common commodities traded are precious metals and base metals. Precious metals for example gold and platinum; base metals being copper and aluminium and the derivatives associated with these underlying instruments. Other commodities that are traded in the global financial world now include agricultural products, weather contracts and even energy products - oil, electricity, etcetera, all fall under what we call commodity trading.

Interest trading or the interest derivative desk would primarily be involved in hedging and trading the yield curves of the local currency in which they had exposure to.

Can you explain what a yield curve is? --- A yield curve is effectively the shape of, if I could put it simply, the shape of interest rates over time. You have positive and you have negative sloping yield curves. Currently in South Africa we have core rates approximately 10¼% and we have the longer end of our yield curve and higher rates in the region of 12½%.

That would show a positive slope and what we would term a positive yield curve. Derivatives on these yield curves would include interest rate swops which effectively convert floating rate exposure to fixed rate exposure and if I could just elaborate on that. The man in the street in South Africa finances his home through a floating rate bond or prime whereas people in America mostly finance their homes through fixed rates.

Bonds: these are normally government bonds or corporate bonds and then CD's. CD's are Certificates of Deposits that banks trade with each other in order to fund their asset and liabilities.

A fourth area within a trading room is a credit derivative trading desk. It is a relatively new trading area. It only really gained much interest in the last five years and credit derivatives are instruments which allow a bank to reduce its exposure or increase its exposure to a particular counterparty.

Foreign exchange I will expand on the foreign exchange desk a bit further.

Moving on to slide 231: in a trading room I have highlighted seven of the major risks that traders, compliance officers and risk managers have to contend with on a daily basis. I would just like to give a brief description of what each risk entails.

First of all volatility risk: volatility is simply the rates and the intensity at which prices move up and down. Volatility and severe volatility would hamper stability in the markets obviously but it also makes it particularly uncompetitive and unprofitable for corporates and institutions to hedge any exposures that they have because the prices that they would be shown by banks, would reflect the current market conditions. They would be more expensive than under normal circumstances.

Currency risk: to put currency risk quite simply, it is the risk associated with movements in currencies that are not your reporting currency. If I can maybe elaborate on that. Any South African institution that has United States dollars or euro exposure in terms of its assets and liabilities, on or off balance sheet, however reports in rand and the movement of these currencies relative to rand, would impact on their profitability.

Interest rate risk: interest rate risk is the risk associated with moving interest rates and again I would refer back to my example of somebody that has a prime link bond in South Africa. Everybody is aware of the risk when interest rates rise rapidly and everybody is also aware of the benefits when interest rates remain stable and move lower.

Liquidity risk: liquidity risk is something that we will deal with a little bit later but if I could just give you a broad definition. It is the risk of loss from the inability to unwind, to offset or hedge a particular transaction or it is the risk associated with not being able to meet a payment obligation.

Country risk: I have already expanded on that. It is the risk associated with doing business in a particular jurisdiction.

Credit risk: to a certain extent it is a subset of country risk. It is a risk associated with doing business with a particular counterparty, person and then what is particularly important in the foreign exchange business is operational and settlement risk. To give you an example there, the foreign exchange market is a high volume, high turnover market and electronic systems assure the necessary settlement of these payments and there is always a dual currency payment which occurs with any foreign exchange transaction and it is necessary for the systems and people to ensure that money is received at the same time that money is paid out. There is no longer a physical check in the foreign exchange market. It is all automated. As soon as a trade is confirmed, it is automatically settled with system. So you run the risk that the counterparty does not send you your leg of the purchase.

Moving on to slide 232. On the financial benefits for banks. What are these benefits for the banks to have trading rooms and why are we in this business?

Firstly, there is a pricing differential due to the different credit quality of the clients. This is a natural consequence of the credit risk that the bank runs in dealing with a particular counterparty.

Secondly, there is a bid office spread which exist for market makers in the banking industry. The bid office spread is typically the margin between the price at which the bank is prepared to buy something and the price at which the bank is prepared to sell the same asset.

Variances in regulatory capital required to be held: regulatory capital determines the type of businesses that banks do. This regulatory capital is determined by the regulating authorities in each particular jurisdiction. In South Africa it is the South African Reserve Bank's banking supervision department.

Banks have access to derivative products which lower the use of regulatory capital to the point of efficiency and allow us to do our business a lot cheaper.

The cost of funding for clients versus financial institutions: the rates at which the general public borrows South African rand is different to the rate at which large financial institutions and corporates are able to raise the same amount of money.

And then most importantly banks: banks had the necessary expertise to manage complicated client transactions and risks and this expertise comes at a price. In the last ten years the type of transactions which are being conducted and the products which are being sold to clients had become very sophisticated. Banks are currently employing well-educated people to manage these risks in their respective dealing rooms. It is not uncommon for banks to hire engineers, material scientists and normal scientists.

I move on to slide 233: I have listed five general counterparties that trading rooms we deal with. Firstly, financial institutions, international and local, generally banks. Secondly, are your corporates, local and international as well. Parastatels or semi-government organisations. Fund managers: these fund managers may be pension fund managers looking for yield curve enhancement or there might be hedge funds and then central banks as well. I concluded with slide 233 with a brief overview of trading in general in trading rooms.

I would like now to move on to slide 234, the foreign exchange market/the global foreign exchange.

Slide 235: what I discuss in the following slides may appear slightly redundant after the discussions and presentations by Mr McCauley for instance but I would like to just quickly run through these and please stop me if you want further clarification.

The first and simple contract that a foreign exchange desk trades is the foreign exchange spot transaction. That is the purchase of one currency against the sale of another for settlement in two business days. I have indicated the typical purchase of $1 million against the rand at a price of R11,50.

If we move over to slide 236: the foreign exchange forward is the same purchase or sale of currency against the sale or purchase of another but for settlement greater than two business days. You will notice again that the rate differs from the spot rate in the spot transaction and I would like to maybe just simplify that process and explain the reason. It has been mentioned in the past that it is directly related to the interest rate differential between the two yield curves or two currencies but to illustrate further if they in this example if an exporter was expecting a million dollar's worth of proceeds in ten months' time, they could sell the dollars today in the spot market but the bank would expect them to deliver those dollars in two days' time. They would then have to borrow the dollars and repay them when they receive their dollars from the counterparty in ten months' time. On the other side they are now sitting what we call long rand because the bank has provided them with rand for only two days. They then take that rand and put it on deposit which they earn interest on and which will fall due in ten months' time. So that is the simple relationship between forward foreign exchange and money market instruments.

If we go on to slide 237. It is the foreign exchange option which again is just simply an insurance contract. It gives the, it provides the rights, not the obligation, to buy or sell a currency on a future date. The fourth set of contracts are foreign exchange swops or cross-currency swops.

On slide 238 is an example of a foreign exchange swop. It is a simultaneous purchase and sale of a currency against another for a forward date. These transactions are primarily used to fund positions and hedge against yield curve moves in two different currencies.

If we move on to slide 239, I have highlighted the three contracts that have an impact on the foreign exchange. The foreign exchange swop and cross-currency swop do not impact directly on the foreign exchange of the currency.

Moving to slide 240, the foreign exchange market because of the massive volume in turnover requires sophisticated technical machines and electronic devices or machines to be able to handle this business. It is the largest expense of any foreign exchange business, are computers and systems necessary to process the transactions. Electronic dealing systems had approximately 85% of all international flows particularly between banks. It is done primarily on two systems Reuters and EBS which I will go on to explain but also there is an increasing amount of foreign exchange transactions occurring via the internet as banks seek cheaper solutions to provide the service to their clients. I made the comment there that the electronic dealing systems now provide greater transparency in the pricing and this is true, I think Mr McCauley also related to the point that a couple of years ago when we really only had voicebrokers, we would use the voicebrokers to trade through. Now the voicebroker would advertise the price that you have showed him and behind the scenes other banks or financial institutions would hear the price being quoted through their telephone system and they would take positions or position themselves according to their estimation of what the transaction size might be or the particular buyers of the price. So a lot of trade would actually be handled because of voicebrokers and this would also relate to the reduction in foreign exchange turnover which we have seen over the last three years. The electronic dealing machine allows for greater transparency because the price is up on the screen. It is there for everyone to view. Prices on these machines are normally quoted on two separate sides of the screen. The one side would be for counterparties that you can transact with. So it is the best price that is available to you as a financial institution and then the second price would be the best price that is available in the market. That price most probable would only be available to the best counterparty credit in the foreign exchange market.

Straight through processing: straight through processing is a somewhat technical term which really relates the ability of these electronic systems to confirm and process and effectively settle these deals without dealer intervention. So after the dealer has concluded his transaction. A button is pressed on the keyboard and the deal flows automatically through the middle office to the back office where it is confirmed, reconciled and settled. This also, however, allows for the administration and monitoring of currency positions on a real time basis versus the old position keeping which used to take place roughly five years ago and longer. I think you have seen, what I have put up here is the Reuters dealing system and on the following slide which I will come to now, I will show you. But to deal with the Reuters dealing system first, currencies in the international market are traded to the fourth decimal which we typically call a pip. The price, and if I use the sterling/dollar price as quoted in the yellow highlighted block on the slide, the current price quoted there is 1,5929 and 1,5931 and the price that a broker would normally be advertising over his telephone would be 2931. That is the terms the trader and the broker are used to. The two RR's indicate the size that that price is good in. R typically refers to $10 million and it stands for regular. The standard transaction size in the South African market on the interbank quote is $3 million.

If we go to slide 242: This system is called EMS. Forgive me I do not know what the EMS stand for. It is a system which was originated out of the Swiss banks and it provides the same sort of pricing to international banks and the reason that these two systems both exist in the international market, is because they each have advantages in terms of liquidity on the dominating currencies. EBS for instance dominates the dollar/Swiss exchange rate and the dollar/Yen exchange rate. No rands trade on the EBS System. The EBS is currently not available in South Africa and it will be later in the year.

Moving on to slide 243: I deal with the different, the three main types of trading practices which would be found on a trading desk, on a normal foreign exchange trading desk. The first is arbitress and arbitress is quite simply the buying and selling of the same asset or a similar asset for a small profit. Now arbitress generally occurs on a foreign exchange desk as a result of two occurrences - because of a large number of electronic pricing systems which are now available to banks. There might be a timing delay on the update of a certain price and if the trader is quick enough he can buy and sell at the same currency for a small profit but due to the efficiencies of the market this very seldom happens and also the profitability of this kind of business is negligible because of this transactional costs involved in settling currency transactions. The most popular arbitress done on the foreign exchange desk is arbitress between forward contracts and interest rate products - money market products and that is which I set out earlier in my example. So as the forward contracts moved out of line with the interest rate derivatives or money market instruments, traders take advantage of this and lock away a small profit. Arbitress is a necessary form of trading in the market as it creates better efficiency for pricing.

Market making: the market maker is an essential member of all foreign exchange desk as it is their responsibility to provide liquidity to the market in currencies that they trade in. A market maker would normally negate his risk by asking another player in the market or another market maker for a price and the profitability of this kind of business really lies in the bid office spread of the price that he is making and his ability and skill to determine the buyers of a particular trading day or the counterparty that he is trading with.

Directional trading: directional trading takes two forms. One is fundamental and the other is technical. Fundamental trading is formulated on macro economic factors of a particular country and this may be due to balance of payment situation, disparities, high levels of inflations, interest rates etcetera. There are a number of economic theories relating to the way that currencies should move. One of them is purchasing power parity theory as an example. The second form of directional trading is what we call technical trading and technical trading is based on an analytical methodology that was developed over the years of studying data where traders effectively look for the answer to currency movements and these are really just mathematical conclusions which lead traders to or signal buy and sell levels for a particular currency or any asset. Technical trading is implemented over a number of assets from equities through to commodities and foreign exchange.

Moving on to slide 244: Profit and loss generated in the foreign exchange desk.

Client transactions: the profit generated from client transactions is typically the spread or the margin that is charged to clients and this would normally wider again reflecting the credit risk that the bank takes on in dealing with this counterparty.

Marketing making: profit is generated by the spread or margin that the market maker is able to charge. High volume turning on a lot of turnover on a daily basis, low margin.

Directional trading: well, this would be the event that was originally expected when the trader got involved in the position occurring either fundamental view happening or a technical or mathematical assumption occurring.

Moving on to slide 245: some aspects of these slides I will repeat what some of the statements Mr McCauley made. Firstly, it is the largest market in the world. It has a daily global turnover of 1,2 trillion US dollars. It operates on a 24 hour basis. The major currency is typically defined as euro/dollar, sterling/dollar, dollar/Yen, dollar/Swiss etcetera contribute to the largest portion of the volume in liquidity and also these major currencies are the currencies that you would be able to find decent liquidity and pricing for on a 24 hour basis.

If we move on to slide 246: this slide is from the BIS, the Bank for International Settlements quarterly review and it provides details of volumes transacted in the international foreign exchange market and again there is the interesting aspect that it continues to grow from 1989 through to 1998 and then there is a sharp fall from 1998 to 2001.

If we move on to slide 247 it indicates why the possibility for this happening. First of all there was the interaction of the euro. The euro constitutes 12 European currencies now. The amount of trade and market making that would have occurred prior to the introduction of the euro would have been substantial as banks would have to hedge client transactions in 12 different currencies and countries. The introduction of the euro does away with this and also does away with the number of traders.

Consolidation of the banking industry: there is typically only 20 global financial institutions left which provide two-way passing in currencies on a regular and 24 hour basis. In 1998 there were approximately 75 of these global players in the market.

The collapse of hedge funds: now a hedge fund is an alternate investment vehicle or provides alternate investment returns to your normal equity and money market returns that you would normally receive. They trade actively in foreign currency, in commodities, in any product which takes their fancy and that they believe they can generate a decent return. The largest publicised collapses were long term capital and the (indistinct) fund which were very active in currencies from 1995 through to 1999 and the activity and the reduction in the activity of these hedge funds could also have added to this decrease in the volume and the international foreign exchange market.

Corporate activity: in the same way that banks are consolidated, corporates have consolidated globally as well and with reference to the $1,2 trillion of turnover, roughly 17% of this global turnover can be attributed to trade or investment lows.

I would like to make three points about trends in the South African foreign exchange market and the first being that the dollar/rand market is dominated by financial institutions in London and Johannesburg with a few that participate in New York although the number of market makers fluctuates and the dollar/rand market continues to attract and at the same time punish new entrance into our market and we find when liquidity in our market is at the highest, we have a number of new entrance in our market and when volatility is at the highest, we have a number of market makers leaving our market. So there was continued fluctuation of people globally participating in the dollar/rand market.

The second point that I would like to make is with regard to dollar/rand options and the volatility products. A large portion of this exposure of the volatility exposure in dollar/rand actually resides offshore. The reason that it resides offshore is that they merely put the rand in a basket of volatility products that they trade. They trade the volatility on interest rates and currencies of most of the emerging markets and these are all grouped in one large volatility portfolio. I make the point of a two tier market and I go back to Mr McCauley's example of the euro/dollar market in the United States that moved from the United States, from the New York floors moved into London and it moved into London purely because the cost of doing business and doing that kind of business in America. Now markets move outside of their domains because of a number of reasons - regulation for instance. Exchange control is a regulation and with exchange control we do not have the free moment of rand and it is possible that a two-tier market can exist where the rand actually trades independent to what is happening in South Africa if we do not have the free-flow of currency and the participation of international banks. The rand is a mature market. It has enticed a number of foreign participants, not only banks, large corporates to invest in the country and any bank or corporate that has invested in the country, would seek a method to hedge their exposure.

The third point that we have noticed over the last couple of years, has been the externalisation of large corporate treasuries from South Africa. The multi-national corporates from South Africa because of their exposures in the international market and a number of countries have moved their corporates offshore purely for profitability point of view: to be able to enhance their borrowings, cheaper rates at which to borrow, efficiencies and the ability to hedge any currency risk that they might have in these countries at more competitive rates in South African banks maybe able to provide them with.

That is an overview of the foreign exchange market and some of the trends in the South African foreign exchange market.

I would like to move on to <u>slide 249</u> that handles the controls under which we are operating. Now the foreign exchange market in a number of jurisdictions is legally defined as unregulated, if I could put that. However, we operate in a very controlled and managed environment and I would like to spell out some of those regulations in this presentation.

<u>Moving on to slide 250</u>: the main controls under which we operate, there are two: regulatory controls imposed by the South African Reserve Bank or any authority in which you operate. In the Reserve Bank there are two departments. The first the exchange control division and secondly banking supervision and then foreign exchange desk operate under their own internal controls. Those are mainly your risk management department/divisions.

<u>Slide 251</u>: regulatory controls exist in all markets and it is typical in all markets for foreign exchange participants, market makers and end-users to supply their regulatory authorities with the relevant statistics on their activity in these markets. The same applies to the South African market.

<u>If we move on to slide 252</u>: I have highlighted a couple of paragraphs on the foreign exchange control circular which I would like to read into the record.

"Hedging can only take place with an authorised dealer who must ensure that the transactions are entered into for hedging and not for speculative reasons and that there is a high correlation between the price of the hedge and the underlying asset/liability or (indistinct).

Authorised dealers are appointed by the South African Reserve Bank. We act as agents on behalf of the South African Reserve Bank and we ensure that the foreign exchange control regulations are met. There is generally two broad definitions of authorised dealers - those that operate that is going to change and others that operate within a bank being able to trade the full spectrum of foreign exchange products. With regard to us determining whether a client of ours, a corporate in South Africa is hedging or speculating, for certain corporates we demand documentary evidence on the transactions that they are entering into. What has recently happened in the South African market is that the large corporations that have a large turnover in the market, have been deemed documentary exempt. So the onus of taking these regulations now falls back on the South African Reserve Bank. From a corporate treasure's point of view the decision whether to enter into a hedge or not to enter into a hedge will be according to his view on what a particular currency might do and may be termed speculative any way. The second paragraph which I have highlighted here, is that authorised dealers may make markets in these instruments, taking positions to be able to service the needs of their corporation customers. Why would an authorised dealer for instance in South Africa want to take a position? The main reason is that he is able to quote more competitively if he already has a position on his books to the corporate. So it is necessary for the South African Reserve Bank to allow South African banks or their authorised dealers to take these positions to be able to service our clients in South Africa efficiently. Now the position that a trader may take, might not suite the particular corporate that comes and asks him for a price that day. However, that same corporate is asking another bank at the same time, might find that that bank has steered his position to suit the corporate's hedge that is required. The third point that I make here is that authorised dealers .. well, the third paragraph is that authorised dealers may also use the permitted instruments to hedge the risks incurred by them in taking these positions. Now there is a generic set of products which are listed. However, because of this investigation of the markets, new products are being developed all the time. Generally what happens any trade in these new products have to be reported. They have to be reported to banking supervision and if they were to impact on the exchange rate, they have to have the approval from the exchange control department.

Mr De Villiers, before you go on to the next diagram, you have spoken now very briefly about speculation etcetera. We have heard this word speculation. What in the financial markets does this speculation mean? What is it really? --- My view of speculation is any transaction where you act as principal.

And it is a normal transaction which you see every day and that you have every day in the markets? --- That is right. Marketing making can be viewed as speculation because you are trading as principal and you have to provide a price to somebody that is asking you and you will, the price that you make, will be speculative in nature because you will move it up and down according to what you perceived that the counterparty is going to do with you.

Thank you.

MS QUNTA: Just before you go on, if you say speculations of course is allowed in terms of the exchange control regulation in the way you have described it now, if you say that the principal try to get a price, what is the difference between speculation which is legal and allowed and manipulation? Are you able to say that or do you want to talk about that later? Because you know that is one of the issues that the Commission has to gruffly with in looking at transactions. Would you like to talk about it later? --- Can we come back to it at the end of my .. (intervenes)

Yes, that is fine. --- Thank you.

If we could move on to slide 253. These are the regulations or some of the regulations to the most important regulations with regard to foreign exchange control or foreign exchange dealing that the banking supervision imposes upon us. First important is the IBDP12 report which is submitted on a daily basis in the South Africa Reserve Bank by the authorised dealers including international banks with South African branches. It provides a summary of all transactions undertaken with resident and non-resident clients giving details of volume, tenor, direction and client name. So at all times the South Africa Reserve Bank has a good idea of a counterparty that South African financial institutions are trading with. This relates to the approximately $8 billion of turnover that we are able to regulate and that we are aware of and that Mr McCauley referred to. The other $3,3 million is outside of our borders unreported by the South Africa Reserve Bank. The second important return that we submit is the DIS extent. It is a daily report send to the South Africa Reserve Bank showing all on and off balance sheet currency movements which are affected in a net open foreign positions of banks. So to put it simply the Reserve Bank has on a daily basis the total currency assets or liabilities of the South African banking community and to what extent the South African banking community is holding currency positions. Then the third point that I make on slide 253 that banks in South Africa and authorised dealers are subject to regular exchange control and banking supervision audits sometimes without prior notification.

Moving onto slide 254. These regulations how did they impact on South African banks trading? Well, South African banks are restricted to a maximum net open foreign position as set out by the banking supervision and this typically 10% of all qualifying capital for that bank. Third, I have made the point already that the South Africa Reserve Bank has at all times the total currency exposure of the South African banking community. The controls within the financial institutions are extremely important. Financial institutions worldwide spent a lot of resource, money and time to ensure that the controls and compliance areas within their trading rooms are efficient and effective and if you analyse all the publicised articles relating to road trading or fraud within trading rooms, you would normally, ultimately it would be as a result of inefficient and uneffective risk management and compliance and a non-segregation of duties within these areas.

CHAIRPERSON: Can you just explain that concept of non-segregation of duties or are you going to come to that? --- Mr Commissioner, I will come to that.

Fine. --- Can we move on to slide 256? Risk management is a core competence of many financial institution and comprises of independent divisions dedicate to management of specific risks.

If we move on to slide 257: now I will outline some of the major risk departments, the most important risk departments that feature in international banks.

Price risk: price risk would be a risk forum or a risk committee that would set the trading limits per product and per currency for a trading desk. They would also check the profit and loss in the attribution per transaction. The profit and loss of any transaction, I just would like to make the statement there is not a direct relation to the size of the transaction and the profit or loss incurred. There is not a direct relationship. However, any large profit or loss that is incurred in the trading day, which stand out and typically be checked by the risk department just to ensure that trades were booked correctly, confirmed correctly and the numbers are correct. Third, ensuring the system check of approved currency rangers to identify off-market trades. Now off-market trades would be trades that are conducted at rates outside of the daily trading range for a particular currency or asset that is trade. Trading at off-market trades is found upon in most dealing rooms and also because of the straight through processing, there is very little dealer interference. Once the trader has been confirmed by the electronic dealing machine, there is no dealer interference. Off-market trades would typically happen with the knowledge of management, risk management, and would normally be part of a structured product. You would very seldom find that vanilla trading contract that have been traded at an off-market rate.

MR BROOKS: What are vanillate trading? It sounds like ice cream. --- Vanilla is a plain flavour. So it is a spot transaction is a vanilla transaction, a highly structured product with optionality built into it. Something which is non-vanilla which is structured. So it is something that just happens on a daily basis is what we determine vanilla. These price risk monitors and they report any excesses on a daily basis through their various control channels.

CHAIRPERSON: That price risk, the question may apply to all the risk managements you are dealing with, is that being done on a daily basis or transactional? How quickly would risk management pick up any abberation? --- Well, it depends on how their systems are set up. It is physically impossible for a particular risk manager to check any foreign exchange transaction. So a lot of them use computer system techniques and they would obviously set parameters to throw out any transactions which might be off-market or have a higher profit associated with it.

So in your risk management division, are there people who are sitting full-time all day doing just that very job? --- I can comment for Investec Bank. Yes, there are and I assume in most international banks there are.

That is how it would work? --- Yes.

Thank you.

MR BROOKS: Would it be picked up within minutes or hours or within a day or a week? What are we talking about roughly? --- It should be picked up at the latest within 48 hours, at the latest.

And when such an abberation is picked up, what happens then? Is it referred back to the dealer or what process does it then go through? --- Well, the process would depend from institution to institution but .. (intervenes)

Well, at Investec. --- Yes, typically the risk manager would come and enquire from the dealer why the trade might have been at off-market or have a high amount of profit associated with it. If he is happy with the explanation, he would then be satisfied. If he is not happy with the explanation, he would contact the compliance officer and their normal internal audit investigations would then take place.

Thank you. --- If we move on to slide 258.

Credit risk: there is normally a credit risk forum or again a committee that approves the clients with which a bank can trade and the limits to which we can trade with these particular clients. In this environment of money laundering, globally it is very important for financial institutions to follow the know your counterparty rule. There is an analysis done per client and per product and the limits and the exposures to these clients are checked on a daily basis to ensure that no excesses exist and again these excesses would be checked and reported if any exist through the normal management channels. Credit risk is particularly important for a bank because the quality of counterparties affects the credit rating assessment by virtue of your affiliation with certain counterparties.

Slide 259: four other areas of control and checks within a South African bank would be your international exchange control department to ensure the compliance of the financial institutions to all exchange control rulings. There are also the conduit for any new exchange control applications. Compliance and legal .. (intervenes)

MR BROOKS: The exchange control department, on how regular a basis would they ensure compliance? Is this on a daily basis, weekly, monthly? --- The internal exchange control department does not, in Investec, does not sit far away from the dealing room. So they would do spot checks and regulated checks on whether the balance of payment system is being updated properly; whether there are transactions with counterparties that we are unaware of, their status etcetera. So it is done.

On a daily basis? --- It might not happen on a daily basis. No, it might not happen.

But at least once a week? --- Yes, at least once a week it should be checked. But again the management and checks and systems are put in place so that your back office staff that are responsible for settling transactions have the ability to report immediately to the compliance officer or to the exchange control officer about a devious trade that might have taken place. Compliance and legal: ensures the compliance with the legal and regulatory obligations of the financial institution. An internal auditor which is a necessary department of any financial institution, checks the financial institution's procedures and reports its findings to the audit committee.

Operations (and Mr Chairman this is where I deal with segregation): it ensures effective settlement reconciliation account of transactions within a segregative framework hence minimising the risk and it is important in all banks to ensure that trades that are booked are then confirmed, settled and reconciled and if all three of these areas are properly segregated, and particularly segregated from the dealer, it would be very difficult for any illegal activity to take place.

MR BROOKS: Mr De Villiers, thank you. That completes your slides? --- That is correct.

Could I just ask you the following: you were present the other day when first of all Mr McCauley gave evidence and Mr Langley thereafter gave evidence. Could you please tell the Commissioners what are your views in regard to ethics what I would call the trading room? Do you have ethical rules, regulations? Are you obliged to comply with those rules etcetera? --- I think all traders are, it is their responsibility to apply ethical standards in their dealing room.

Let me ask you this: is there a printed or written code somewhere out there? --- The ACI of South Africa accepted their code as the standard practice's code for South Africa. It has yet to be accepted by the governing authorities and regulators. That is still in the process. So the code is not enforced if I may put it that way.

CHAIRPERSON: Is that the model code? --- That is the model code. The point is that I believe traders should adhere to things that are lawful, honest, that does not breach any client confidentiality and that you do not lead your client astray.

MR BROOKS: And does that happen as far as you are concerned? --- I can only speak for my experience in Investec and it does happen there.

Then could I just please ask you we have now heard evidence from numerous witnesses in regard to the rapid depreciation of the rand from about September to December last year. Now looking at this depreciation from your eyes out of the trading room, what are your views as to what were the major contributors to that rapid depreciation and you do not have to give them in any particular order if there is of course more than one? --- 2001 was characterised a lot of negative sentiment in South Africa. We have heard of the Zimbabwe crisis. We know for a fact that the South Africa Reserve Bank was intervening in the foreign exchange market by buying dollars to negate their net open foreign position. There was a lot of underlying negative sentiment in the market.

About the buying? --- About those things. International analysts were continually writing articles referring to those topics mainly. We then had the delay of the Telkom privatisation which hit the press in one way or another in August, I think, and we had the drastic effects of September 11 which I think had a substantial impact on the South African market. So what typically happens in a disaster like that, is that there is a flight of capital back into a safety zone and the flight of capital moved back into US treasuries where we saw massive gains in the US treasury markets. The rand obviously started to depreciate at quite a rapid rate after September 11 and then the introduction of circular D342 on 15 October.

Is that the Reserve Bank's circular? --- That is the Reserve Bank's circular. It was not at all an extension to exchange control. It just set out to once again explain what the exchange control was about. However, it was done in a different way this time. It expected South African banks to notify their international counterparts and it also requested us to get a compliance officer in the international bank to write in writing and provide us with details of why they would be doing the transactions. Now I believe it was detrimental to the liquidity of the dollar/rand because you had a number of participants in the offshore markets that took time to debate this introduction of the circular and rather to be safe then and pull out of the markets, we had a drop in liquidity when we drastically needed liquidity and stability in the markets and I think thereafter we took (inaudible) which is typical of any major depreciation in the currency.

And that all contributed to the decrease? --- Yes.

Could I just ask you lastly from my point of view, I dealt briefly with speculation just now. It seems to have a negative connotation. Do I understand you to say that it is not really negative, it is just the normal dealing in the market? Will that be a correct summary? --- Yes, I think we need to clarify why speculation in South African press has a negative connotation. It is mainly referred to the long directional trading where traders take a long term position of shorting the rand against the dollar and they do it for large amounts. Day to day speculation in the form of market making, in the form of technical trading is a necessary function for any market. It helps a market to be efficient and obviously helps people who need hedges to hedge properly and cheaply.

CHAIRPERSON: I think that comes back to a question that my fellow commissioner posed earlier about speculation as compared to manipulation. --- Yes.

MR BROOKS: Can you just then distinguish with manipulation as opposed to speculation? I think that is where I am trying to go to, to take you to the commissioner's question. --- I think I would say manipulation is an ethical means without any underlying reason but to harm a currency, not even harm but move a currency in a particular direction using the markets.

MS QUNTA: Can you give us an example of that because you see that is the problem, I am just trying to understand the mechanism in a trading room? Could you give us a hypothetical example of manipulation? --- Well, I would suppose the unethical spreading of rumours that have no base that are completely untrue. You are to a certain extent manipulating the market.

CHAIRPERSON: And does that happen the spreading of malicious rumours or rumours not based on facts? --- I do not know. I am not aware of rumours originating and spreading. Rumours are something that do occur in any market. Rumours are what caused markets to move and sometimes rumours do have truth behind it. It is just that the rumour comes out and the fact might appear a week later but unsubstantiated rumours that are started, is highly unprofessional.

Mr Brooks, are you completed?

MR BROOKS: I have no further questions. Thank you.

MR GANTSHO: Another example that was given by an earlier witness, Mr Langley, was a case where two dealers would collude to create a transaction, a false transaction only to reverse it later. What controls are there in your organisation to prevent that kind of an action? --- Well, he mentioned if a trade is cancelled. If dealers were colluding to the extent that .. to collude on a once off spot transaction would have no impact. You would need to be colluding consistently throughout the day. Now in most banks there is an audit trail relating to all deals cancelled. The compliance department would quickly determine the nature of these cancelled transactions, why they happened. You know through straight through processing nowadays the number of cancelled transactions because there is limited dealer interaction in any deal now, is few and far between. The deals are typically transacted because a corporate client that is dealt on the telephone might have dealt through the incorrect date, incorrect transaction and a rate was entered. Those are your standard cancellations that you have in the market.

CHAIRPERSON: So you are saying that if a phenomenon of cancellation grows there would be a suspicion that that might be some form of manipulation? There would be an audit trail and then somebody through the risk management would pick it up? --- Somebody should pick it up and query it.

And then call for explanations for why there are so many cancelled transactions on that day for example? --- Yes, because I presume that he would be colluding with one or two banks at most and that name would be common on all of these cancelled transactions.

We will adjourn for tea, Mr De Villiers, but we will not be long after tea. We adjourn for 15 minutes until 11:30.

PROCEEDINGS ADJOURN

ON RESUMPTION

PATRICK DE VILLIERS (s.u.o.)

CHAIRPERSON: Mr De Villiers just a few questions.

MS QUNTA: I wanted an example Mr De Villiers, you were talking about a market maker. I think I recorded a slide, market making, if you can - I wanted, because this term has come up several times in the last few days and I just wanted you to explain to me or give me an example of when you are involved in market making say in a transaction what actually happens. Let me just see the slide, do you have the slide number you mentioned.

CHAIRPERSON: Mr De Villiers perhaps you can start by expounding on the term market maker and then you can go down to a specific... --- The market maker is exactly what the word says, he makes the market, so he puts the value.

MS QUNTA: He puts the? --- The value or the price on the asset that he is trying to buy or sell.

Would it be currency or? --- Yes let us assume, let us use something relevant like the dollar/rand exchange rate.

Okay, would that be regarded as the product, the dollar/rand exchange rate as a unit? --- That is right that is a product that he would trade in. He would be typically asked for a price and the price that he would show to the market or to the corporate customer would be based on a number of factors. The movement that he might have experienced the previous day, what he saw happened during the evening if there was any global catastrophe, global economic movements, that is his underlying basis for making decisions. More relevant however would be what he sees from the time he has walked in in the morning to his desk. Now a counter party comes and asks him for a price. Let us assume it is a corporate and he is expected to make what we call a two way price, a buying and selling price because he does not know what the corporate needs to do. Whether the corporate needs to buy dollars or sell dollars, so he makes a two way price. Now that price will be skewed in favour of either buying dollars or selling dollars.

Depending on where he stands. --- What he is comfortable to do that day.

Okay. --- So if he has the fundamental belief that there might be a bit of pressure on the dollar/rand exchange rate and it might trade slightly higher he will be in favour of buying dollars for the day and being skewed that way. So if he is lucky enough and the counter party happens to be an exporter and gives him the dollars he is now sitting with the position that he wants. And he is now able to wait for the importers that have been creating this demand over the last couple of days to come and take the dollar off of him at a higher rate. That is how he generates his profitability.

But where does it come from, what base does it come from. He would come from the price that it was last night or would he just pull a price out of his ... (intervenes). --- No, no.

Okay. --- No the thing moves as a series. It might trade in New York times, then might have a couple of trades in Singapore time. Remember the dollar/rand is not an extremely liquid currency outside of Johannesburg and London trading hours, so he would walk in the next morning, he would have a record on his automatic dealing machine of the last trade that was recorded or transacted and then he will - someone will start, you know someone will have to quote a price, the market starts to quote a price and if he had now been dealt on his price, he might be completely out of the market, way off, from where the (inaudible) that day but he will soon find out because somebody will put him into an adverse position. Now he as a market maker would be sitting with a position that he is not comfortable with. He the has to go and ask another market maker for a price so that he can get into the position that he is comfortable with. So the market goes around and this is why I liked the analogy of Mr McCauley of a hot potato business, because the market will ask each other for prices and they will trade with each other until they all have a position that they are now happy with and then you start ... (intervenes).

Is that how the price is ultimately determined, is that how, whether it is in rand or dollars or Yen, everywhere in the world that is how, that is what happens actually, in determining the price. --- It is ultimately related to a supply and demand factor.

Is there, and probably you have answered this question, is there a difference between the way trading rooms operate in this country and the way they operate abroad? I suppose you have just answered my question, they operate in exactly the same way. --- That is correct. CHAIRPERSON: Using the same technology? --- Using the same technology. South Africa is for an emerging market has a particularly mature market, we are technically advanced and a lot of people are pleasantly surprised when they actually do pay South Africa a visit.

MS QUNTA: I want to come t the Reserve Bank circular that you have mentioned. I have asked this from other witnesses who came. Perhaps I do not understand because from the circular we have seen and I have read that, if the Reserve Bank is going to implement the existing exchange control regulations and people have to comply with them, my first question in relation to that is why would the market regard that as negative. What would - and I am sure, have you seen the circular, unless we are not talking about the same circular.

CHAIRPERSON: No it is the same circular. --- Circular D342.

In other words just explain to us what it was that had the impact, why did it have an impact.

MS QUNTA: Because you see the circular, I think it was in Mr Gouw's bundle, the circular says "the enforcement of existing rules serves to ensure that only legitimate transactions take place" in other words there must be an underlying reason for that. Wasn't that the case before the circular came out. Wasn't it so that you could not and you put it up there on the board that you could not just make a deal where there is no - you cannot hedge or speculate when there is no underlying reason. Wasn't that the case before the circular came out? --- Okay if I could also just give a little bit of background about the circular. A similar enforcement was - came into the market during the height of the Asian crisis in 1998, the Reserve Bank enforced the same rules. It was withdrawn two weeks later because of the marked lack of liquidity that followed on from the circular. Now we look at the re-introduction of the circular 15 October 2001. We all understand as authorised dealers that we operate under the ambit of the foreign exchange control, however when you now have to ask a counter party that sits off-shore for their compliance officer to provide you with written evidence that the trades that they are currently conducting are not for speculative purposes but are to hedge an underlying asset or commitment in South Africa. There is a large difference, because the compliance, because we were then expected to report all banks, all international banks that are not compliant with our questions back to the South African Reserve Bank. So a compliance officer in the international banking sector is an incredibly responsible position. They will not put their signature on anything because they will be liable for criminal prosecution. What happens with these international market makers and participants in the rand, the compliance officer would typically say to them until I have understood this regulation that the South African Reserve Bank is requesting I would prefer that you guys pull out of your market making activities and your general activities in the dollar/rand. So that was the first negative point for the market. We had a reduction in the number of market makers almost immediately, foreign market makers but by the same time confusion reigned among the local market makers and authorised dealers about how this was going to be managed and how it actually impacted on the currency.

I am reading paragraph 3 which I think is the essential paragraph that deals with that and probably we will ask the Reserve Bank on Monday but it does not say anything here about a local banking institution having to ask the counter party because it actually says that

"this does not restrict the ability of a non-resident investor to either hedge or repatriate the sale proceeds of investment in South Africa, it does however exclude the financing of short run positions in the domestic market which is consistent with the requirement that domestic borrowing by non-residents investors is subject to certain restrictions."

Now ... (intervenes). --- Sorry let me qualify, the circular that came out as a consequence of a meeting held on Sunday 14 October is exactly what you are reading out. After that banks met with the South African Reserve Bank to clarify their position on that and that came out as a consequence of it.

But was it written anywhere what you are saying to me now what came out of the subsequent meeting. Is there any written statement from the Reserve Bank which says - because it is not in - what you have just said about the requirements for off-shore investors is not in the circular of 14 October. Hence my puzzle about you explaining the lack of liquidity. --- To the best of my knowledge there would have been written correspondence particularly from the Department of Exchange Control with regard to the management of this and I know for a fact that we were asked by members of the Exchange Control Department to provide evidence of banks that had not complied.

Okay perhaps the commission will try and obtain a copy to this. My last question in relation to this is the - Mr Brooks asked you what you thought the reason for the decline, the rapid depreciation of the rand and you said the main reason was negative sentiment. You mentioned Zimbabwe, you mentioned the Reserve Bank circular, are you able to state categorically or factually that that is the case or are you simply surmising that that is one of the reasons for the depreciation of the rand? --- That is my personal view.

Your personal view. --- That is correct.

How do you then, are you able to explain, because, in fact the situation in Zimbabwe has worsened right now, I think the violence has increased in the run up to the elections, and the government has just ignored another supreme court ruling so and I do not think the negative sentiments has moved from South Africa but the rand yesterday or Monday was at R10.84, it has appreciated so how do you explain that then? --- I think it is an overdue correction of our currency. We are still not at the level where I would say it has now been a satisfactory retracement from this anomaly which occurred between October and December. The risk factors and the event risk leading up to this weekend still exist in our currency. If we had corrected to R8.50 I would surmise that the market now believes that Zimbabwe is not a major threat from a contagion point of view.

And I take the point that you have said that is just your personal view because what would be more useful for us is actually a factual analysis of this depreciation of the rand and certainly probably some of the reasons you have indicated may be correct but at this level my impression is it is your personal view and it is speculation. --- That is correct but if you look at the way international analysts have written about South Africa for the past year a lot of these topics are repeated in their views on South Africa. Social unrest, Zimbabwe contagion, the fact that our privatisation programme might be delayed. Someone sitting in New York for instance and has never been to South Africa, his only insight into South Africa is what banking analysts and economists are writing.

Okay I take your point, I mean I suppose we are not going to come to some final conclusion but I think it was quite useful your presentation because we - it is the second view we have had of the trading room and it is probably useful for some of the commissioners to go into a trading room because it seems quite fascinating. Thank you. No I have no further questions.

CHAIRPERSON: Just back to the circular of 14 October, I am left with the impression that there must have been an informal market that had developed in the trading in the currency where the traders were not requiring an underlying transaction. Am I wrong in coming to that view? In other words when the Reserve Bank said we are here to enforce now you must show us and it would be the compliance officer that there was documentary proof of an underlying transaction, that really clamped down on what one might call an informal market in regard to the trading in the rand. --- I would not say the market was informal, the South African Reserve Bank is well aware of how we conduct our business within the international foreign exchange market. The only difference is that you now from international banks, not only from local corporates, you had to have documentary evidence or a compliance officer signing off that these were not for speculative purpose but for hedging transactions. In the past this was not the case because you are doing a large volume of transactions through electronic dealing systems where there is no space for opportunity on the system while quoting a price to a counter party to ask him whether he is hedging or speculating, it is just for practical reasons.

Was it the foreigners, essentially the foreign banks who then withdrew from the market? --- Yes I think the foreign banks were put on hold by their management and compliance officers because it is a local step for them to take while they look at the legality of the document and the impact. The local market however because the confusion reigned with regard to (inaudible) forex swop transactions of which we have already seen that South Africa has a high percentage versus the rest of the market. Did it pertain to spot transactions. And in a meeting that the ACI which is effectively the representative body for foreign exchange traders in South Africa had with the Reserve Bank the Reserve Bank noted that they wanted us to maintain the liquidity in the dollar/rand spot market because I think they understood the impact that it might have. These - D342 pertains purely to swop transactions because as I illustrated earlier it is a funding transaction, it is a funding transaction.

And were you here earlier this week when we saw that graph of how the number of transactions dropped quite dramatically in November and then increased slightly in December? --- Yes.

Is that a reflection of your experience at Investec too? --- It is a reflection of our experience and we surmise that it dropped, the volumes dropped because of the reduced percentage of market makers in the market and then increased because of importer panic and investor panic so there was a lot more fundamental trade flow that was happening through the last two months of the year, which had to be covered through the market.

MS QUNTA: Sorry Mr De Villiers we heard evidence earlier on, I think Mr Langley indicated that immediately after the circular came out the rand actually appreciated for the next few days, and - that does not seem to me to be consistent with market players pulling out because the impression I have from what you are saying is that the market became less liquid and also, perhaps you can answer this, that - your meeting with the Reserve Bank and we will try and follow up with the Reserve Bank to see if there is anything in writing which would have asked you to do an additional duties to what you were obliged to do because this circular, all it says is that we will enforce existing exchange control regulations. Just a comment on the appreciation.

CHAIRPERSON: Can you explain it to me. --- Yes the appreciation which occurred for two days after 15 October, the Monday and the Tuesday is a natural consequence of traders sitting on-shore and off-shore that were holding long dollar positions, getting out of their long dollar positions by selling those positions and buying rand until they were confident that they understood what the implications of the circular were, so as I think as you pointed out madam commissioner it is a - it is not a new role pertaining to foreign exchange control it is actually just a re-enforcement of the rules that we currently understand and know about. Once the market understood that the rand continued on its depreciating part. If you look at any shocks in any currency markets there are always corrections, where people try and figure out what the impact of the news is, or the newsflash or the rumour, there is an immediate correction.

And in your view when did that correction take place then, I think you just said but I did not catch the time. --- I think it was two or three days from the Monday.

That the circular came out? --- That is correct. Because the banks were asked to meet with the South African Reserve Bank if I am correct on Monday 14 October and that circular was explained.

And in your view Mr De Villiers having given some of the facts, not facts, some of your views about the depreciation there was a - well the depreciation was over a period of time, but in the space of 20 days in December the rand depreciated by 40%, having surmised some of the reasons that had made it possible would you say, would you exclude in terms of the terms of reference of the commission we have to look at transactions, would you exclude the possibility that transactions would have - certain transactions and you know we do not know at this moment we are busy looking at that, would have had an impact on the exchange rate? --- Let me express my view on transactions. Hedging by corporates is reactionary.

You have to explain that because reactionary has a political connotation sometimes, I do not understand it in a no-political way.

CHAIRPERSON: Well it has a plain English meaning, perhaps he should give it to us.

MS QUNTA: Yes. --- I beg your pardon.

Plain English.

CHAIRPERSON: Give us the meaning that you ascribe to it as a banker.
--- Well I would say corporate treasurers and hedges that are put on place would normally, they would normally do it because of something, because of an underlying belief that they have in the market or of what they are currently seeing in the market.

MS QUNTA: A perception. --- Yes, so that is what I mean by reactionary to what is actually happening to the currency. So it is extremely difficult to look at transactions in November and December when your currency was on a very very steep depreciating path. You can only assume that importers would panic because the corporate treasurer might not have been prudent through the rest of the year in covering forward and you have investors who now have portfolios in South Africa which any gains which they have made in the equity or bond markets are being depleted by the currency depreciation. So that is what I mean during that period you can expect people to climb into the markets and it is a very typical example is what happened with the dollar Yen currency yesterday and last night. A large American bank brought out a research report that they believed that the bond rally and equity rally has peaked out in the United States and that they think there is major value in the Yen economy, in the Japanese economy and you had portfolio flow, the currency has moved beyond people's wildest expectations for one day.

And as a result of those actions whether it is by importers or whoever else in brackets those actions would have also an impact on the exchange rate, the actions that those people took. --- Yes.

CHAIRPERSON: Any more questions?

MS QUNTA: No thank you.

MR BROOKS: Sorry can I put one more question.

CHAIRPERSON: If you must Mr Brooks yes.

MR BROOKS: Mr De Villiers it has been suggested by certain witnesses who gave evidence before the commission that the Reserve Bank's actions in actively buying foreign currency to reduce the NOFP had an influence on the rand and contributed to the depreciation of the value of the rand, could you comment on that please? Do you agree with the statement or do you disagree with the statement? --- The Reserve Bank had a net open foreign position of I think the number is $23,8 billion at the end of 1998, in terms of providing liquidity to the dollar/rand market as we went through the Asian crisis, this was reduced to approximately $4 billion over the last couple of years. So yes they were active in buying dollars in the market. This would have constantly put pressure on our currency. If you take into consideration the amount of dollars that were purchased the currency fared very well up to July 2001. But it would have been a contributing factor, it was something that the international analysts kept on pointing to.

But if they bought these dollars in the market what happened to the dollars thereafter where did they go to? --- Well the NOFP is a consequence of dollars that they have sold in the past either through forward contracts offered to parastatals or through dollars that they borrowed and used to sell into the market to try and provide stability to the currency. So there are these dollar commitments or liabilities which exist and those, as they fall due, so they need to be repurchased in the market.

Sorry can I just put it in simple terms.

CHAIRPERSON: We are going to have a lot of evidence bout this, you do not have to ask this witness who has not come to give this evidence, you realise that Mr Brooks.

MR BROOKS: No but this, Mr Commissioner what we are trying to establish is whether he agrees with and this is what happens in his ... (intervenes).

CHAIRPERSON: Yes but remember that Mr De Villiers was not asked to give evidence about the NOFP. He was asked to give evidence according to his slides and I am concerned that we are entering a thing that he was not asked to come and testify about.

MR BROOKS: Yes. No I asked him whether certain factors in his view contributed to, I think this is one of the factors which he mentioned.

CHAIRPERSON: Yes.

MR BROOKS: I am going to be very brief, I just want to ... (intervenes).

CHAIRPERSON: Listen carefully to me Mr Brooks, Mr De Villiers was not called to give evidence about the NOFP he was called to give evidence about what he did give evidence about. There is a lot of other evidence coming including this afternoon as you know about the NOFP.

MR BROOKS: Very well Mr Commissioner, but this is something that happens in his field, that is why I put those questions to him.

CHAIRPERSON: I just think it is unfair, the witness was not consulted about this, he was not called to give evidence about the NOFP. I do not want him to comment beyond what he agreed to come and testify about at the request of the commission. He is here at our request remember.

MR BROOKS: Yes, very well Mr Commissioner.

CHAIRPERSON: Are you finished?

MR BROOKS: I am finished.

CHAIRPERSON: Mr De Villiers we appreciate your contribution that you made at the request of the commission, thank you very much. We will adjourn until 14:00.

COMMISSION ADJOURNS