

Part E: The Wakeford Allegations

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E The Wakeford Allegations

The evidence of Mr Wakeford

1 During December 2001 Mr Kevin Wakeford, Chief Executive Officer of the South African Chamber of Business (“SACOB”), formed the view that a formal enquiry was desirable to investigate the causes underlying the rand’s decline. He was at a loss for an explanation for the rand’s decline. He regarded the decline of the rand as a matter of national importance. On 30 December 2001 Mr Wakeford publicly called for the establishment of a commission of enquiry. On 2 January 2002 he was orally informed by an informant, whom he described in evidence as highly revered and credible, about certain transactions and mechanisms which could have contributed to the rapid depreciation of the rand. The informant told him that the mechanisms and transactions had been reported to the Reserve Bank, but the Reserve Bank had not taken any action. On 4 January 2002 Mr Wakeford publicly repeated his call for the establishment of a commission of enquiry. On 7 January 2002 Mr Wakeford repeated that request to the Presidency. On the following day, 8 January 2002, at the request of a senior official of the Presidency, Mr Wakeford in “great haste and in a great rush” prepared and submitted a “report on dubious financial methods that have impacted the rand” (“the

Report”) to the Presidency. A copy of the Report is attached to Part E as Annexure “A”. On the same day, 8 January 2002, the Presidency announced the appointment of this Commission. According to Mr Wakeford, in announcing the appointment of the Commission, Mr Bheki Khumalo, a spokesman for the Presidency, stated that “the Presidency had received information from a number of other sources relating to the rand’s rapid depreciation.”<sup>1</sup>

2 When testifying, Mr Wakeford read onto the record a written submission (“the Submission”). A copy of the Submission is attached to Part E as Annexure “B”. Mr Wakeford testified that the Submission was not substantively different to what was communicated to the President; was more carefully thought through<sup>2</sup>; and contained one (or more) deliberate retractions on advice from his attorneys to protect himself<sup>3</sup>.

3 Mr Wakeford motivated the call by him for a commission of enquiry. He said that he received numerous enquiries from SACOB members regarding the rapid depreciation of the rand. He detected a degree of panic emerging in the market place. He and those he consulted were at a loss for an explanation. Even without the information he obtained from

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<sup>1</sup> Evidence of Wakeford, Record 773-776

<sup>2</sup> Wakeford Record 771-2

<sup>3</sup> Wakeford, Record 798

his informant, he would have called for a commission of enquiry. It was an issue of national importance. Mr Wakeford testified that Dr Ebrahim of the IMF indicated to him his concern that South Africa was on the edge of a financial crisis. Mr Wakeford provided these statistics: between February 2001 and February 2002, the producer price of maize rose by 127%; at one time in 2002 the price of maize was R2 200 per ton whereas in 2001 it was R700/800 per ton. The price of wheat rose by 30%, sunflower by 62% and beef by 25%. Assuming that the rand was R11.30 to the US dollar, food prices for the poor would increase on average by 30% and “a 30% increase on a very low income that absorbs your disposable income is something very frightening.” Argentina, whose currency depreciated by 75%, experienced food riots.<sup>4</sup>

- 4 Mr Wakeford refused to disclose the identity of his informant. He admitted that the sole source of information contained in the Report was his informant and that he had taken no steps to verify the information.<sup>5</sup> The mystery surrounding the identity of the informant gave rise to speculation in the media<sup>6</sup> that Mr Wakeford’s informant was Mr James Cross, the former Senior Deputy-Governor of the Reserve Bank. Mr Cross in evidence refuted that speculation before the Commission and

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<sup>4</sup> Wakeford Submission, Record 775, 778-9, 782

<sup>5</sup> Wakeford, Record 792-806

<sup>6</sup> Bundle SARB (8) 234

emphatically denied that he was the informant.<sup>7</sup> At the request of the Reserve Bank, the chairman of the Commission asked Mr Wakeford to confirm that Mr Cross was not his informant. Mr Wakeford did so. Mr Cross, perhaps unwittingly, gave evidence which might throw some light on the source of the information provided to Mr Wakeford. Mr Cross testified that in late August 2001 he was approached by two representatives of a local branch of a foreign bank. They wished to test a financing mechanism for off-shore acquisitions by South African companies. After details of the proposal were put to Mr Cross and his colleagues, the representatives of the foreign bank were told that the Reserve Bank would not agree to the proposed structure. Some time later in September or early October 2001 Mr Cross received a telephone call from another person working for the same foreign bank. In essence, the complaint was that the Reserve Bank had approved a similar structure (to the one proposed and rejected in late August 2001) and that the result of the structure would be negative for the rand. Mr Cross thereupon requested Mr Grové of the Reserve Bank to review the transaction. Mr Cross' recollection is that the corporate involved in the transaction was said to be Sasol.

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<sup>7</sup> Cross, Bundle SARB (8) 231

- 5 The Commission is left with the strong impression that Mr Wakeford's informant was employed by the local branch of the foreign bank referred to by Mr Cross. One must bear in mind that Mr Wakeford's informant told him that the "dubious transactions and mechanisms had been reported to the Reserve Bank but that the Reserve Bank had, for whatever reason, taken no action" and the informant alleged that the core management of Deutsche Bank, which had dealt with the Reserve Bank in regard to the transactions in question, had "a historically privileged position and relationship with the Department of Finance and the Reserve Bank". If the informant worked for a foreign bank, a rival to Deutsche Bank, the information relayed to the President in the Report was hearsay based on hearsay. Not surprisingly, then, the information turned out on investigation to be inaccurate in a number of material respects.
- 6 The material allegations in the Report, Annexure "A" hereto, which were investigated by the Commission, in brief, were these:
- a dubious and peculiar share transaction involving Deutsche Bank and Sasol was concluded;
  - the foreign capital which Sasol obtained from the share transaction was used to finance the Condea acquisition, potentially under false pretences;

- Deutsche Bank, having become over-exposed to rand denominated Sasol shares, dumped rands in the local, thin, market;
- there was a strong likelihood that Sasol and Deutsche Bank colluded to cause a drop in the value of the rand in order to strengthen their economic position in relation to a fall in oil prices;
- it was rumoured that Nampak, M-Cell and Billiton were in the process of following similar strategies;
- Deutsche Bank's core management had a historically privileged position and relationship with the National Treasury and Reserve Bank.

7 In the Submission and evidence, Mr Wakeford did not persist with the allegation that there was a special, unhealthy or cosy relationship between Deutsche Bank and the Department of Finance or the Reserve Bank. There was also no evidence of such relationship placed before the Commission.

8 The National Treasury led evidence to rebut any such suggestion:-

- The National Treasury did not receive any application from Deutsche Bank in 2001. There were discussions between

National Treasury and Deutsche Bank about a possible Sasol transaction in 2000 but no application in that regard was made to National Treasury. During 2000 the National Treasury received several Reserve Bank requests on behalf of the MTN Group. On 12 March 2001 MTN made a slide presentation to the Minister of Finance and National Treasury. No application, however, was ever submitted to National Treasury. All the MTN applications were dealt with and resolved by the Reserve Bank.<sup>8</sup>

- Deutsche Bank Johannesburg (“DBJ”) was appointed a primary dealer in the domestic bond market in April 1998. Eleven other institutions were also appointed after due process was followed. From time to time South Africa has borrowed in the international capital market since 1994. A total of 17 transactions including public bonds, private placements and a syndicated loan were concluded during this period, three of which were lead managed by Deutsche Bank. There are no credit lines or liquidity support that the National Treasury has provided to Deutsche Bank, nor did the National Treasury receive any private credit lines or liquidity support from Deutsche Bank. In July 2001 the Reserve Bank and the National Treasury concluded a syndicated loan of

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<sup>8</sup> Evidence of Mr C Malan, Chief Director, Financial Regulation, National Treasury, National Treasury 2 Bundle 1; Record 1127

USD1.5 billion as co-borrowers. Deutsche Bank was one of thirty-one institutions that participated in the loan. A former employee of National Treasury, Mr Richard Ketley, left the National Treasury in 2000 and joined Deutsche Bank in its bond market section. Mr Ketley has since left Deutsche Bank and is presently at Stanbic Africa.<sup>9</sup>

- 9 The evidence for the Reserve Bank was that applications for Exchange Control approval submitted by DBJ or Deutsche Securities are not
- treated differently from applications submitted by other authorised dealers; or
  - given any preference.<sup>10</sup>
- 10 The Presidency furnished the Commission with a copy of the Report. The Commission thereupon appointed a team of assistants to investigate the allegations contained in the Report. The evidence was subsequently led before the Commission of Mr Wakeford; the institutions mentioned by him in the Report, namely, (using his descriptions) Sasol, Billiton, Nampak, M-Cell, Deutsche Bank; the Department of Finance; the

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<sup>9</sup> Evidences of Mr B Molefe, Deputy Director-General, Assets and Liability Management, National Treasury, National Treasury Bundle 2 (9); Record 1132

<sup>10</sup> Evidence of Mr CT Grové, Assistant General Manager, Exchange Control, Reserve Bank Record 1188

Reserve Bank and the leader of the team of assistants which had investigated the allegations.

### Billiton

- 11 BHP Billiton SA Ltd (“Billiton”) regularly receives proposals from various banks and financial institutions with regard to a wide variety of potential transactions. During November 2000 Billiton was approached by London representatives of Deutsche Bank with a loan structure proposal involving aluminium linked financing. A number of discussions took place between Deutsche Bank and Billiton during 2001. During January 2002 a final decision was taken not to pursue the proposal due to Billiton’s concerns in regard to the tax implications of the proposed structure. Billiton did not enter into any structured finance arrangements with or through Deutsche Bank during the period 1 January to 31 December 2001 or thereafter. Deutsche Asset Management’s shareholding in BHP Billiton Plc as at 31 December 2001 was 1.65%. BHP Billiton Plc is the ultimate holding company of Billiton.<sup>11</sup>

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<sup>11</sup> Evidence of Mr AP Brugman, the Treasurer of Billiton, Record 819

### The regulatory framework

12 Before analysing the Sasol, Nampak and M-Cell transactions for which DBJ or Deutsche Securities obtained approval from the Reserve Bank, it is necessary to sketch the regulatory framework in which those applications were made, granted and implemented.

13

13.1 The evidence given on behalf of the Reserve Bank<sup>12</sup> was that authorised dealers are not empowered to grant any South African corporate the authority to make a foreign direct investment. Such corporate is obliged, through an authorised dealer, to submit a written application to Exchange Control for authority to do so. Exchange Control is required to be in possession of sufficient information regarding the transaction, its nature and purpose, before consulting with the National Treasury or exercising the authority delegated to it by the Minister of Finance. In considering any such application submitted by an authorised dealer on behalf of a South African corporate, Exchange Control

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<sup>12</sup> Evidence of Mr CT Grove, Assistant General Manager, Exchange Control Department, Reserve Bank: Bundle SARB (8) 6

takes into account not only the merits of the particular case and the circumstances giving rise thereto, but also equality of treatment of all similar requests. Any such application can only be considered properly if Exchange Control is in possession of sufficient information. It is the duty of the authorised dealer on behalf of its South African corporate client to verify the content of each application and to ensure that all applications are fully detailed and presented in an acceptable form. Any application must state clearly the corporate's reasons for wishing to undertake the transaction; what benefits will accrue to South Africa either in the short or the long term; and whether there might be subsequent or other related transactions.

- 13.2 Once the application has been approved by Exchange Control, it is incumbent on the authorised dealer concerned to ensure that the transaction or transactions in respect of which authority has been given are finalised on the particular basis on which it was formally approved by exchange control. Exchange Control requires that the authorised dealer must verify, as and when the underlying transactions are implemented, that any conditions laid down by exchange control had been adhered to.
- 13.3 It is the view of Exchange Control that, in the event of an applicant – a South African corporate – or its authorised dealer

implementing a transaction or series of transactions which formed the subject matter of an application to Exchange Control (“the main application”) and such implementation of a transaction or those transactions:

- deviates in any manner from the authority granted by Exchange Control; or
- takes place in any manner not disclosed to Exchange Control in the main application; or
- involves further or ancillary transactions not disclosed in the main application, then, and in that event, such implementation would constitute a contravention of the Exchange Control regulations. It is important to emphasise that it is the view of Exchange Control that included in “further or ancillary transactions not disclosed in the main application” would be a hedging transaction entered into as a consequence of the main application.

13.4 Applications by South African corporates to invest overseas are considered by Exchange Control in the light of the national interest. In terms of Exchange Control policy, the purpose of Exchange Control over direct investment abroad is to prevent the loss of foreign currency reserves through the transfer abroad of capital held in South Africa and to help to avoid undue pressures

on South Africa's foreign exchange reserves. Such investment, in terms of that policy, must result in a longer term benefit to the country, such as the promotion and/or enhancement of exports of both goods and services, including technology, through the protection of existing markets and the development of new ones and the protection of essential imports of goods and technology.

13.5 South African corporates are also allowed to utilise their local cash holdings in South Africa to partly finance new investments whether cost thereof exceeds the respective amounts of R750 million and R500 million. Such additional foreign currency transfers are restricted to 10% of the cost in excess of those amounts irrespective of the size of the transactions. The balance of the finance required must still be raised abroad by the South African corporate and may be so raised, on application to exchange control by means of certain approved transactions. One of them, and the only one that is relevant for the purposes of this commission, is what is described by Exchange Control as “a share placement”.<sup>13</sup>

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<sup>13</sup> In their evidence the corporates and Deutsche Bank referred to the transactions in question by various names, including “asset swaps”. The label is irrelevant. In substance all the transactions were “share placements” as defined by the Reserve Bank.

13.6 Exchange Control's definition of a share placement is the placement of a listed South African corporate's own shares with long-term foreign investors on the basis that:

- the listed shares to be placed may consist of a new share issue by the South African corporate or existing shares bought back by the South African corporate, and
- the long-term foreign investors must in consideration of the placement with them of those shares, pay to the South African corporate the foreign currency abroad to finance the approved foreign acquisition, to refinance an existing approved foreign investment or to finance an expansion of an existing approved foreign investment.

13.7 In addition to the requirements set out above, in considering an application for foreign direct investment, Exchange Control, as a matter of policy, imposes the following pre-conditions to any authority granted:

- the transactions when implemented must be reserves neutral, i.e. when the transaction is implemented there must be no negative impact on the country's total foreign exchange reserves;
- all share placements must take place at arms-length and at market related prices or values;

- the South African corporate is required to advise Exchange Control via its authorised dealer on a periodic basis as determined by Exchange Control of the success or otherwise of the share placement and of the flow-back to South Africa of the shares placed. “Flow-back” means those shares of the South African corporate which have been placed with a foreign vendor and which have found their way back to South Africa and have been purchased by and registered in the names of South African residents.

14 We now turn to consider the three share placement transactions by having regard only to the essence of each transaction.

#### Sasol

15

15.1 Condea was the chemical business of RWE-DEA, a subsidiary of RWE, the largest utility company in Germany. Condea’s business was concentrated in the surfactant value chain and in oxygenated solvents. After a competitive bid process for the acquisition of Condea, Sasol was declared the successful bidder and entered into an agreement with RWE-DEA for the acquisition

of Condea. The effective date of the acquisition was 1 March 2001. The total purchase consideration was €1.3 billion (in round numbers). The acquisition was financed by a loan, the use of the foreign investment allowance (R500 million plus 10% of the purchase price), a revolving credit facility and a share placement.<sup>14</sup> It is the share placement element of the financing of the Condea deal which is relevant.

15.2 On 25 January 2001 DBJ applied to Exchange Control on behalf of Sasol to raise up to €350 million (R2.6 billion)<sup>15</sup> by means of an off-shore share placement and to utilise the proceeds to re-finance a portion of the foreign loans raised to finance the acquisition of Condea. The terms of the share placement were to be as follows:

- existing Sasol shares held by wholly owned subsidiaries of Sasol would be placed with long-term foreign investors;
- the transaction was to take place at market related prices;
- it was proposed that the placements would be transacted with long-term non-resident institutional clients of Deutsche Securities (Pty) Ltd (“Deutsche Securities”) of whom seven specified clients were named;

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<sup>14</sup> Evidence of Mr A Coetzee of Sasol Ltd, Sasol Bundle 12-17

<sup>15</sup> The figures in this section of the report are rounded off

- no South African party would participate in the proposed share placement.

15.3 On 30 January 2001 Exchange Control informed DBJ that the proposed share placement was approved. It was noted that long-term foreign investors would subscribe for the shares and that no South African party would participate in the share placement exercise. The shares were to be placed at market value. DBJ was requested to keep Exchange Control posted on a six monthly basis as to the success or otherwise of the placement which should include full details of any flow-backs that might have occurred.

15.4 On 16 February 2001 Deutsche Securities, in a letter addressed to Exchange Control, confirmed that the share placement would take place as follows:

- Deutsche Securities would purchase shares in Sasol and on-sell/place these with long-term foreign investors;
- Sasol would pay Deutsche Securities the rand value of the shares placed in South Africa;
- Sasol would receive the foreign currency (proceeds from the sale of the shares) directly into their off-shore account for the account of an entity approved by the South African Reserve Bank;

- no conversion from rand to foreign currency would take place on behalf of Sasol.

15.5 Exchange Control responded on 21 February 2001 in which it confirmed that it was agreeable to Deutsche Securities acquiring the shares in Sasol in the secondary market and on-selling those to long-term foreign investors for payments off-shore; all costs towards the purchase of the shares by Deutsche Securities were to be settled locally in rand by Sasol to ensure a reserves neutral position at all times.

15.6 On 25 June 2001 DBJ reported to Exchange Control that:

- a total of 39.7 million Sasol shares had been placed;
- proceeds of €34 million (net of expenses) were raised through the placements and that these were used in part settlement of the purchase price of Condea;
- the euro proceeds were settled directly for the account of Sasol Investment Holdings (Pty) Ltd (“SIH”);
- shares were placed with Deutsche Bank AG, London, (“DBL”) who had undertaken to Sasol that they would not sell the shares for a period of twelve months other than to other suitable long-term foreign investors;

- DBL had subsequently sold a total of 9.6 million shares to foreign investors.<sup>16</sup>

15.7 As of 28 March 2002, DBL had placed 16.8 million of the original number of shares acquired in 84 separate placement transactions.

15.8 On 15 January 2002 Deutsche Securities informed Exchange Control that flow-back from a Sasol share placement had been low and estimated that about 6% (2.3 million shares of the original 39.6 million shares) had flowed back to South Africa.<sup>17</sup>

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<sup>16</sup> Grové, Bundle SARB (8) 19 - 21

<sup>17</sup> Grové, SARB Bundle (8) 175

## Nampak

16

- 16.1 In 2000 Nampak Ltd (“Nampak”) decided to finance its United Kingdom Expansion through an equity injection into its wholly owned United Kingdom subsidiary, Nampak Holdings (UK) Plc (“Nampak Holdings (UK)”). The proceeds would be used to partly fund the capital expenditure programme planned for Nampak Plc, a subsidiary of Nampak Holdings (UK). The capital expenditure was estimated in November 2000 to be £50 million.<sup>18</sup>
- 16.2 On 28 November 2000 DBJ made application to Exchange Control for Nampak through Nampak International Ltd (“Nampak International”) to raise up to £25 million (about R277 million) by means of a share placement. The application was supplemented on 11 December 2000. The application was initially turned down. On 12 December 2000 the application was renewed and then granted by Exchange Control on 14 December 2000.
- 16.3 The share placement was to take effect as follows:

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<sup>18</sup>

Evidence of Mr J Sayers, Nampak Bundle 6; Grové, SARB(8) 40

- Nampak shares to the rand value of £25 million would be placed on the Johannesburg Stock Exchange with long-term foreign investors;
- the sale proceeds would be received by a Nampak subsidiary in rands;
- the rands would be converted into pounds on the day the share placement was transacted.

16.4 Exchange Control authorised the transaction on terms similar to those in the Sasol application (set out in §12.2 hereof), save that, in addition, the proceeds of the share placement were to be received off-shore and capitalised in the books of Nampak Holdings (UK).

16.5 It was Nampak's understanding that the transaction would be "currency neutral" in that no rands would leave South Africa.

16.6 On 21 June 2001 Nampak advised Deutsche Securities that it could proceed with the share placement. On 27 June 2001 Nampak Products bought, through the agency of Deutsche Securities, 13.8 million shares in Nampak for R171 million. On 3 July 2001:

- Nampak paid Deutsche Securities R171 million for the shares (and as the payment should have been made by Nampak Products, a book entry was subsequently made);

- Nampak Products sold the shares to DBL for £15 million;
- DBL paid £15 million to Nampak International on behalf of Nampak Products for the shares (the first tranche).

16.7 On 3 August 2001 the second tranche for £5 million of the £25 million authorised share placement was effected in a similar fashion to the first tranche and the relevant payments were made on 7 August 2001.

16.8 By 28 March 2002, DBL had placed 10 million out of a total of 18.3 million Nampak shares in 27 separate transactions.

### M-Cell

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17.1 In February 2001 Mobile Telephone Networks Holdings (Pty) Ltd (“MTN Holdings”) acquired a cellular licence in Nigeria for USD285 million. On 23 August 2001 Mobile Telephone Networks (Pty) Ltd (“MTN”) sent a request for proposals to six financial institutions as to how its strong balance sheets and free cash flows could be used to retire the off-shore US dollar debt in an amount of USD250 million. On 30 August 2001 Deutsche Securities responded in a letter addressed to M-Cell Limited (“M-Cell”) setting out its proposals:

- the payment by M-Cell of rands to Deutsche Securities;
- the payment of foreign currency by DBL to M-Cell;
- the foreign currency would be generated by the placing of M-Cell shares with long-term foreign investors;
- DBL “would effectively underwrite the placement of shares off-shore”. The proposals were acceptable to M-Cell.

17.2 On 25 October 2001 DBJ made application to Exchange Control to raise USD75 million by means of a share placement. In addition to the share placement scheme outlined above, DBJ informed Exchange Control that the share placements would be implemented in a number of transactions over the following six months as market conditions allowed. On 15 October 2001 DBJ informed Exchange Control that the cash flows would be as follows:

- the rand value in respect of the M-Cell shares purchased in the open market would be paid to Deutsche Securities by MTN;  
and
- the foreign currency proceeds from the sale of the M-Cell shares to foreign investors would be paid directly to Mobile Telephone Networks International (Ltd) (Mauritius), a wholly owned subsidiary of MTN via Mobile Telephone Networks Africa (Pty) Ltd.

17.3 On 15 November 2001 Exchange Control approved the application and pointed out that suitable steps had to be implemented in order to minimise any flow-back to South Africa and that Exchange Control reserved itself the right to call on the applicants to re-finance any flow-backs to the Republic to ensure reserves neutrality.

17.4 On 8 January 2002 M-Cell instructed Deutsche Securities to proceed with the approved transaction up to a value of the rand equivalent of USD20 million. The first tranche of the Deutsche Security proposal, which involved the placement of 15.7 million M-Cell shares with foreign investors was settled on 25 January 2002 as follows:

- an amount of R232 million was paid by MTN Holdings to Deutsche Securities on 25 January 2002 in payment of M-Cell shares purchased from South African residents;
- on the same date DBL paid an amount of USD20 million to MTN International in return for the M-Cell shares to be placed with long-term off-shore investors.<sup>19</sup>

17.5 As of 28 March 2002 DBL had placed 7.2 million of the 15.7 million M-Cell shares.

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The evidence of Mr RD Nisbitt, M-Cell Bundle 8; Grové SARB (8)

## Findings

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18.1 The Sasol, Nampak and M-Cell share placements in themselves:

- were not dubious nor peculiar;
- were legal;
- were in accordance with Exchange Control approvals;
- when implemented did not contribute to the rapid depreciation of the rand;
- were reserves neutral.

18.2 The Condea transaction was not funded by Sasol “potentially under false pretences” nor did Sasol and Deutsche Bank collude to cause a drop in the value of the rand.

## The Deutsche Bank hedging, funding and related transactions

19 The controversy, both from an exchange control and rand exchange rate perspective, relates to the hedging, funding and related transactions undertaken by Deutsche Bank in respect of each of the share placements. The evidence given on behalf of Deutsche Bank<sup>20</sup> in regard to those

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<sup>20</sup>

Evidence of Mr N Smith, Deutsche Bank Bundle Part (2) 9

hedging and other transactions was exhaustive and is available for analysis by any interested party. For our purposes it is sufficient to set out the various transactions in broad terms as described by Deutsche Bank.

Sasol share placement hedging, funding and related transactions

20

- 20.1 In order to hedge the *market* risk in respect of DBL's holdings of the Sasol shares, DBL and Deutsche Securities entered into a forward sale transaction on 22 February 2001 in terms of which DBL agreed to sell to Deutsche Securities 38.4 million Sasol shares at a price equal to their market value in rands on the date of implementation of the share placement plus interest.
- 20.2 In order to *hedge* DBL's currency risk in respect of DBL's holdings of DBL's Sasol shares, DBL, as a non-resident, exchanged R2.5 billion for €350 million on 19 and 20 February 2001.
- 20.3 In order to fund DBL's holdings of unplaced Sasol shares, DBL and DBJ entered into a re-purchase transaction on 26 February 2001 in terms of which DBL sold South African Government

bonds to DBJ for which DBJ paid DBL R2.4 billion. This amount was equal to the value of the bonds.

20.4 In order to manage the cost relating to the holdings of bonds purchased under the re-purchase transaction and the Sasol shares purchased by DBL, DBL loaned 38.4 million Sasol shares to DBJ on 23 March 2001.

20.5 Deutsche Bank contends that the effect of the share placement, hedging, funding and other transactions on DBJ and DBL was as follows:

- DBL purchased Sasol shares;
- DBL hedged its market risk relating to the shares;
- DBL hedged its currency risk by selling South African bonds and exchanging the rand proceeds for foreign currency; and
- DBL and DBJ balanced their currency positions.<sup>21</sup>

20.6 Deutsche Bank avers that the exchange of rand for foreign currency pursuant to the currency hedge on 19 and 20 February 2001, which was at least seven months before the start of the rapid depreciation of the rand in October 2001, did not contribute to the depreciation of the rand – on the contrary, the rand/US

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<sup>21</sup> Smith, Deutsche Bank Bundle Part (2) 10

dollar exchange rate strengthened on 19 and 20 February 2001 and over the entire month of February 2001.<sup>22</sup>

Nampak share placement hedging, funding and related transactions

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- 21.1 In order to hedge its *currency* risk in respect of tranche 1, DBL, as a non-resident, exchanged R170 million for £15 million. In order to hedge its currency risk in respect of tranche 2, DBL exchanged R59 million for £5 million. The exchanges were executed on 26 June 2001 and 24 July 2001 respectively.
- 21.2 In order to hedge their *market* risk in respect of tranche 1, DBL and Deutsche Securities entered into a forward sale agreement on 27 June 2001 in terms of which DBL agreed to sell to Deutsche Securities 13.8 million Nampak shares at a price equal to their market value in rands on the date of implementation of tranche 1 of the share placement plus interest. DBL hedged its market risk in respect of Tranche 2 by entering into put-and-call contracts on the South African Futures Exchange (“SAFEX”). The expiry date of the contracts is 19 September 2002 and the strike prices are R13.96.

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<sup>22</sup>

Smith, Deutsche Bank Bundle Part (2) 12

- 21.3 Deutsche Securities hedged its market risk in respect of tranche 2 by entering into put-and-call contracts on SAFEX. The expiry date of the contracts is 19 September 2002 and the strike prices are R13.96.
- 21.4 DBL obtained funding of about R170 million and R54 million from DBJ by way of re-purchase transactions. In terms of the re-purchase transactions, DBL sold South African Government bonds with a value approximately equal to its funding requirements to DBJ and DBJ paid DBL an amount in rand equal to the value of the bonds.
- 21.5 In order to manage the cost relating to the holdings of bonds purchased under the re-purchase transactions and the Nampak shares purchased by DBL, DBL loaned the unplaced Nampak shares to DBJ on 9 October 2001. As security for the obligations under the security loans, DBJ transferred South African Government bonds to DBL. The bonds had a market value similar to the Nampak shares.
- 21.6 Deutsche Bank contends that the effect of the share placement and the hedging, funding and other transactions on DBJ and DBL was as follows:
- DBL purchased Nampak shares;
  - DBL hedged its market risk relating to the shares;

- DBL hedged its currency risk; and
- DBL and DBJ balanced their currency positions.<sup>23</sup>

21.7 Deutsche Bank avers that the exchange of rand for foreign currency occurred on 26 June 2001 (£15 million) and 24 July 2001 (£5 million). The rand strengthened on 26 June 2001 and on 24 July 2001.

#### M-Cell share placement hedging transactions

22

- 22.1 In order to hedge its *currency risk*, DBL, as a non-resident, exchanged R231.8 million for USD20 million on 8 January 2002.
- 22.2 DBL hedged its market risk in respect of the M-Cell shares by entering into put-and-call contracts on SAFEX. The expiry date of the contracts is 21 June 2002 and the strike prices are R15.05, R15.28 and R15.78.
- 22.3 Deutsche Securities hedged its market risk in respect of the M-Cell shares by entering into put-and-call contracts on SAFEX. The expiry date of the contracts is 21 June 2002 and the strike prices are R15.05, R15.28 and R15.78.

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<sup>23</sup>

Smith, Deutsche Bank Bundle Part (3) 146

22.4 Deutsche Bank contends that the only transaction involving the exchange of rand for foreign currency was the currency hedge referred to in §22.1 (the exchange of R231.8 million for USD20 million on 8 January 2002). This occurred after the period during which the rand depreciated.<sup>24</sup>

### Exchange Control's Concerns

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23.1 Following on the request made by Mr Cross referred to in §4 Part E, Exchange Control held discussions and entered into correspondence with Deutsche Securities and DBJ about the *Sasol* share placement. The correspondence ended with two letters from Deutsche Securities dated 18 February 2002 and 26 February 2002. In the evidence given on behalf of Exchange Control on 8 April 2002, Mr Grové expressed the opinion that on the face of it the following discrepancies appeared between the Sasol application which was approved and the letters of 18 February and 26 February 2002:-

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<sup>24</sup>

Smith, Deutsche Bank Bundle Part (4) 362

- the original Sasol application for a share placement transaction did not disclose all the related or subsequent transactions, i.e. the hedging, funding and other transactions;
- the details of those transactions were not immediately disclosed;
- some or all of the hedging, funding and other transactions prejudiced the obligation placed on DBJ to ensure reserves neutrality. On 26 March 2002 Exchange Control gave DBJ the opportunity to respond in writing to its concerns.<sup>25</sup>

23.2 At a meeting between Exchange Control, DBJ, DBL and Deutsche Securities on 12 February 2002 DBJ was requested by Mr Grové to provide Exchange Control with a full report on the *Nampak* share placement. On 26 February 2002 DBJ responded by providing Exchange Control with a written explanation by Deutsche Securities. Exchange Control is of the view that on the face of it, the following discrepancies appear between the *Nampak* application and the approval granted by Exchange Control in regard thereto and the letter of 21 February 2002:

- the application for a share placement did not disclose all the related or subsequent transactions which were implemented or

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<sup>25</sup>

Grové, Record 1169-1174

were to be implemented, i.e. the hedging, funding and related transactions;

- the currency risk hedging transactions (in terms of which DBL exchange R170 million for £15 million and R59 million for £5 million) did not maintain or ensure reserves neutrality.<sup>26</sup>

23.3 At the meeting of 12 February 2002 Mr Grové requested DBJ to provide Exchange Control with a full report on the *M-Cell* share placements. On 21 February 2002 DBJ responded by providing a written explanation from Deutsche Securities.

23.4 Exchange Control is of the opinion that on the face of it the following discrepancies appear when regard is had to the *M-Cell* applications and the M-Cell approval and the letter of 21 February 2002:

- the original M-Cell application for share placement did not disclose all the related or subsequent transactions, i.e. the hedging transactions;
- the currency risk hedge in terms of which DBL exchanged R231.8 million for USD20 million on 8 January 2002 does not maintain and/or ensure reserves neutrality.<sup>27</sup>

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<sup>26</sup> Grové, [Record 1178-1180](#)

<sup>27</sup> Grové, [Record 1186-1187](#)

23.5 On 26 March 2002 Exchange Control called upon DBJ and Deutsche Securities to address its concerns. The interaction between Exchange Control, DBJ and Deutsche Securities in which Exchange Control reviewed the Sasol and Nampak share placements and the hedging, funding and related transactions was a parallel process to the one conducted by the Commission (“the review process”).

24 Under cross-examination by counsel for Deutsche Bank, Mr Grové testified on 8 April 2002:-

- It was not disclosed to Exchange Control at the time the share placements were approved that DBL would “warehouse” the shares. On the contrary, it was stated that DBL would be one of the long-term foreign investors. Nevertheless, had DBJ or Deutsche Securities applied for approval of the share placements on the basis that DBL would warehouse the shares, Exchange Control would have considered the application on that basis.<sup>28</sup>
- Had Exchange Control been made aware, at the time the applications were made, that the hedging, funding and other

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<sup>28</sup>

Grové, Record 1193-5

transactions would be concluded, Exchange Control would not have approved the share placements.<sup>29</sup>

- At the time the applications were made, Exchange Control did not know and did not assume that DBL would hedge its risks.<sup>30</sup>

### Deutsche Bank's contentions

25 Deutsche Bank contended in evidence that the hedging, funding and related transactions were either specifically approved by the Reserve Bank or fell within general Reserve Bank approvals:-<sup>31</sup>

25.1 DBJ applied to the Reserve Bank by letter dated 9 February 2001 for approval of the forward sale transaction between DBL and Deutsche Securities in respect of DBL's market exposure on the Sasol shares. The Reserve Bank approved the transaction by letter dated 13 February 2001.<sup>32</sup>

25.2 DBJ applied to the Reserve Bank by letter dated 18 October 2001 for approval of the forward sale transaction entered into between DBL and Deutsche Securities in respect of DBL's market

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<sup>29</sup> Grové, Record 1195-1200

<sup>30</sup> Grové, Record 1196-1200

<sup>31</sup> Smith, Deutsche Bank Bundle (6K)

<sup>32</sup> Smith, Deutsche Bank Bundle (6B)

exposure on the part of the Nampak shares. The Reserve Bank approved the transaction by letter dated 18 October 2000.<sup>33</sup>

25.3 The purchase and sale of SAFEX contracts fall within the general Reserve Bank approval that permit non-residents to trade in securities and financial instruments listed on South African exchanges.<sup>34</sup>

25.4 Any non-resident, including DBL, is free to undertake transactions in rands without Reserve Bank approval, and this occurs on a regular basis. Accordingly, DBL, as a non-resident, did not require Reserve Bank approval to transact the currency hedges.<sup>35</sup>

25.5 Re-purchase transactions between residents and non-residents fall within the general Reserve Bank approval set out in section E.5 (E)(i) of the Rulings. Re-purchase agreements between DBL and DBJ are arranged, transacted and reported to the Reserve Bank on an ongoing basis.<sup>36</sup>

25.6 Securities loans by non-residents to residents are common. Such loans fall within the general Reserve Bank approval set out in Section E.5(E)(ii) of the Rulings. The approval permits the

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<sup>33</sup> Smith, Deutsche Bank Bundle (6C)

<sup>34</sup> Smith, Deutsche Bank Bundle (6C)

<sup>35</sup> Smith, Deutsche Bank Bundle (6C)

<sup>36</sup> Smith, Deutsche Bank Bundle (6D)

borrowing of securities listed on the JSE by authorised dealers from non-residents on condition that the loans are secured by the pledge of certain types of assets.<sup>37</sup>

25.7 Subsequent to the transactions being entered into, the re-purchase and securities loan transactions were reported to the Reserve Bank by DBJ. This was done in the normal course of DBJ's business in accordance with normal practice.<sup>38</sup>

26 Deutsche Bank dealt in evidence with the Reserve Bank's concerns that the hedging, funding and other transactions were not "reserves neutral":-

26.1 The term "reserves" means the gold and foreign currency held by a central bank. The term is not generally used in any other context. The Reserve Bank seems to ascribe a wider meaning to the term. The Reserve Bank has not published its understanding of the term. There is also no general consensus amongst experts on what the Reserve Bank means by the term. A number of different meanings have been suggested by economists and experts. The following meanings appear the most likely:

- it is possible that the Reserve Bank understands the term to mean the net foreign currency pool of all South African

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<sup>37</sup> Smith, Deutsche Bank Bundle (6D-6E).

<sup>38</sup> Smith, Deutsche Bank Bundle (6E)

residents, i.e. the aggregate of all foreign currency held by South African residents;

- it is also possible that the Reserve Bank means the gross foreign reserves of the South African monetary sector.

26.2 On whatever definition the Reserve Bank might use, the hedging, funding and other transactions were, in aggregate, “reserves neutral” i.e. the transactions did not result in a net outflow of rand from South Africa. In the case of the Sasol and Nampak funding transactions, DBL introduced non-resident owned bonds into South Africa, foreign currency having been introduced in South Africa to acquire the bonds in the first instance.

26.3 Smith was not aware of any provision in the Exchange Control Regulations, the orders and rules made pursuant thereto or the rulings that require share placements to be “reserves neutral”.

26.4 In the Reserve Bank approvals and related correspondence with Deutsche Bank, the Reserve Bank refers to the term “reserves neutral” only in limited instances, for example, in relation to the Sasol share placement the Reserve Bank stated: “all cost towards the purchasing of the shares by your institution must be settled locally in rand by the company [Sasol] involved to ensure a reserves neutral position at all times.” Deutsche Bank’s understanding of the reference to “reserves neutral” is that the payment by Sasol to Deutsche

Securities should be settled in rand and not in foreign currency.

The payment was in fact settled in rand.

- 26.5 There is no condition in any of the share placements to preclude DBL or any other foreign investor in the shares from hedging its currency exposure in respect of the shares by exchanging rand for foreign currency.<sup>39</sup>

#### The investigation of the Wakeford allegations

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- 27.1 The team the Commission appointed to investigate the Wakeford allegations consisted of a forensic auditor, structured finance specialists and an attorney (“the team”). The team interviewed Mr Wakeford. As he was not able to substantiate the allegations made in the Report, the team conducted its own investigation. Consultations were held with DBJ, Sasol, Nampak, M-Cell, Billiton, the Reserve Bank and National Treasury. Having determined that Billiton did not conclude a share placement with Deutsche Securities, the team concentrated on the other transactions. The team prepared a report. The leader of the team,

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<sup>39</sup>

Smith, Deutsche Bank Bundle (6H) – (6I)

Mr Papadakis, gave evidence before the Commission after evidence had been led by the entities named in the Report.<sup>40</sup>

27.2 The material conclusions of the team in regard to the Sasol share placement and the hedging, funding and related transactions were:-

- (1) The effect of the conversion of R1.8 billion for €250 million on 19 and 20 February 2001, if viewed in isolation, would be that the total foreign currency reserves of South Africa were reduced by €250 million.

Mr Papadakis was cross-examined by counsel for DBJ. The contention advanced on behalf of DBJ in essence was that “...there was an inflow of foreign currency into [South Africa] in consequence of an acquisition of bonds by [DBL].”<sup>41</sup> Mr Papadakis disputed that it was a purchase of bonds. He testified that according to the records of DBJ there was a bond *re-purchase* transaction of R2.4 billion, which was “in economic terms a loan” and hence there was no inflow of foreign currency into South Africa.<sup>42</sup>

- (2) On the days the currency conversion was effected, 19 and 20 February 2001, the rand appreciated in value. The team

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<sup>40</sup> Evidence of Mr G Papadakis, Gobodo Bundle 1-20; Record 1518-1575

<sup>41</sup> Evidence of Papadakis, Record 1540 line 13

<sup>42</sup> Evidence of Papadakis, Record 1538-1539, 1544

was not in a position to provide any conclusion as to whether or not that transaction contributed or gave rise to the rapid depreciation of the rand.

27.3 The material conclusions of the team in regard to the *Nampak* share placement and the hedging, funding and related transactions were:-

- (1) The effect of the conversion of rands for pound sterling of R170 million for £15 million on 26 and 27 June 2001 and R59 million for £5 million on 2 August 2001 was that the foreign currency reserves of South Africa were depleted to the extent of the conversion.
- (2) The rand appreciated in value on 26 June and 2 August 2001 but depreciated on 27 June 2001. The team was not in a position to provide any conclusion as to whether or not those transactions contributed or gave rise to the rapid depreciation of the rand.
- (3) The application of the foreign currency proceeds received by Nampak was not applied strictly in accordance with the approval granted by Exchange Control. Any deviation from the basis on which an application is approved needs to be submitted to Exchange Control.

The application was approved by the Reserve Bank on the basis that the pound sterling would be used “...to fund the capital expenditure programme of Plysu PLC”. The team discovered, in the words of its report, that the funds “...were initially utilised to reduce the loan raised from the syndicate of banks to settle the purchase price of Plysu.” In evidence it became common cause between the team and Nampak that the funds were used to settle the loan and that the team regarded this discrepancy as a side issue. The Reserve Bank then placed on record that this was “a minor deviation in the overall scheme of the transaction as a whole and with the benefit of hind-sight the Exchange Control Department says that they would have agreed to the request.”<sup>43</sup>

27.4 In regard to the *M-Cell* transactions, the team concluded that:

- Deutsche Bank utilised its own funds to underwrite the transaction;
- DBL exchanged R231 million for USD20 million on 8 January 2002 as a hedge of its currency risk;
- the M-cell shares which were unsold by DBL were sold subsequent to 31 December 2001;

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<sup>43</sup>

Evidence of Papadakis, Record 1571-2

- the M-Cell share placement was implemented during January 2002 (which falls outside the period of the investigation).

## 28 The response of the Reserve Bank

- 28.1 Mr Bruce-Brand returned to the witness box on 7 May 2002 to deal with the evidence which had been given since he had last testified.
- 28.2 He testified that Exchange Control approved twelve share placements/corporate swaps to the value of approximately R22.9 billion. Seven approvals were not proceeded with. Only transactions totalling approximately R4 billion were implemented.
- 28.3 Mr Bruce-Brand emphasised that for exchange control purposes the reserves are the total gold and foreign exchange reserves of South Africa. In an exchange control environment “reserves neutrality” cannot reasonably refer to any other reserves. Mr Van Zyl’s evidence was that there are three components of South Africa’s reserves. Firstly, the Reserve Bank reports on the reserves on page S102 of its Quarterly Bulletin and one month in arrears on the Reserve Bank website. At the moment the reserves

are USD7.6 billion of which about USD1.6 billion is gold and the rest is foreign exchange reserves. Secondly, there is a smaller amount, about USD4 billion under control of the authorised dealers. The authorised dealers are aware in what categories they are allowed to invest and what categories are excluded to them. A third category of reserves is one under the control of the Government from time to time.<sup>44</sup> On page S102 of the Quarterly Bulletin the Reserve Bank reports on “gold and other foreign reserves” under these headings:

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<sup>44</sup>

Evidence of Van Zyl, Record 1694-5

Reserve Bank		Rest of Monetary Sector	Central Government
Gold Reserves	Foreign Exchange Reserves		
	SDRs*	Other	

\* "SDRs" means Special Drawing Rights

28.4 The amounts which are allowed to be invested abroad by South African corporates (R750 million or R500 million plus 10% of the cost of the investment in excess of those amounts) negatively impact on the reserves of the country. South Africa is prepared to accept that decrease in the foreign reserves. Where the investment exceeds the allowed amount, the investment cannot be allowed to take place in any manner which may negatively impact on the reserves of the country. When agreeing to a share placement, Exchange Control requires that, save for the allowed amount, reserves neutrality is maintained. Any flow-back that occurs must be rectified.

28.5 It is Exchange Control's contention, consequently, that no transaction should be engineered, under any guise, to exceed the permissible outflows prescribed by the Minister of Finance.

28.6 In considering the share placements in issue, the question is whether bonds were purchased by DBL and whether DBL paid for the bonds or not. Exchange Control would not take into account the foreign exchange which may or may not have come into South Africa's reserves for the purpose of adjudicating upon the relevant share placement transactions. Acquisitions of South African assets by non-residents built up prior to an application to Exchange Control for a share placement would definitely not be considered by Exchange Control as a motivating factor.<sup>45</sup>

### The Settlement Agreement

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29.1 The review process that commenced in October 2001, in terms of which Exchange Control reviewed the Sasol and Nampak share placements and the hedging, funding and related transactions which Deutsche Bank put in place, culminated on 22 May 2002 with the conclusion of a Settlement Agreement between Exchange Control and Deutsche Bank. On 24 May 2002 the

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<sup>45</sup> Evidence of Bruce-Brand Bundle SARB (9) 1-3

Commission was informed that the Settlement Agreement was confidential in terms of s33(2) of the South African Reserve Bank Act, 90 of 1989. Exchange Control and Deutsche Bank brought an application for an in camera hearing, which the Commission granted, in which the terms of the Settlement Agreement were disclosed to the Commission.<sup>46</sup> On 28 May 2002 the Commission acceded to a request by Deutsche Bank that the Settlement Agreement be made public. The Reserve Bank did not object. The Commission thereupon published the Settlement Agreement and Annexure 1 thereto. The Settlement Agreement and Annexure 1 thereto are attached to Part E as Annexure “C”.

29.2 The material terms of the Settlement Agreement were that DBJ and Exchange Control agreed that the Deutsche Bank group would implement a set of transactions described in Annexure 1. The intention was to address Exchange Control’s concerns regarding reserves neutrality, while at the same time not requiring the unwinding of any of the asset swaps/share placements in related transactions (Clause 2). Once the transactions referred to in Annexure 1 had been implemented, those transactions would gradually be unwound as the share placements continued (Clause 3). As security for the undertaking that DBJ would ensure that the

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<sup>46</sup>

Record 1763-1765

Deutsche Bank group would enter into the transactions, DBJ would deposit R10 million with the Reserve Bank on the business day following signature of the settlement agreement. The deposit would be interest free. The deposit would be repaid to DBJ once DBJ had provided Exchange Control with documentary evidence confirming completion of the transactions set out in Annexure 1 and DBJ had appointed a person who was suitably qualified in exchange control matters to take responsibility for all DBJ's communications with Exchange Control (Clause 4). The Settlement Agreement was concluded without admission of liability or wrongdoing on the part of the Deutsche Bank group (Clause 6). The Settlement Agreement was in full and final settlement of all claims, disputes and proceedings of any nature that either party might have against the other in relation to the asset swaps/share placements and related transactions (Clause 7).

### Legal Submissions

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At the end of the public hearings, the Commission was not clear on what the *legal duties* of DBJ were in relation to disclosure of information and reserves neutrality. Accordingly, on 30 May 2002 the Commission sought clarity from Exchange Control and DBJ in a letter

addressed to each.<sup>47</sup> In short, the questions which were posed to the parties were:

- whether DBJ was under a legal duty to make disclosure and ensure reserves neutrality;
- if so, in terms of which law those duties arose;
- whether the breach of any legal duty relied on by the Reserve Bank in those circumstances constituted prima facie evidence of criminal conduct, such as a contravention of Regulation 22 of the Exchange Control Regulations;
- if the Reserve Bank contended that DBJ was not in breach of a legal duty, whether the Reserve Bank contended, in the words of §1.3.4 of the Commission's Terms of Reference, that those transactions were in breach of the "spirit" of the exchange control regulations, and if so, how?

31 The Reserve Bank's submissions are contained in a letter addressed to the Commission dated 6 June 2002, a copy of which is attached to Part E as Annexure "F". DBJ's submissions are contained in a letter to the Commission dated 7 June 2002, a copy of which is attached to Part E as Annexure "G".

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<sup>47</sup> The letters are Annexures "D" and "E" to Part E

32 Attorneys acting on behalf of DBJ addressed a letter to the Commission dated 7 June 2002 in which it was submitted that it was not appropriate for the Commission to deal in its final report with the legality and ethics relating to the share placements and related transactions. A copy of the letter is attached to Part E as Annexure “H”. A similar submission had been made orally on behalf of the Reserve Bank during the in camera hearing on the final day of the Commission’s hearings. In the Reserve Bank letter of 6 June 2002, Annexure “F” to Part E, the Commission was advised by the Reserve Bank that it did not withdraw those oral submissions.

### Regulation 12

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33.1 The Reserve Bank submitted that in terms of regulation 12 of the regulations governing the Commission’s proceedings, the Commission should not make a finding or recommendation concerning the disputes between Exchange Control and DBJ, the disputes having been resolved in the Settlement Agreement.

33.2 Regulation 12 provides:

“Whenever the Commission is satisfied upon evidence or information presented to it that the Commission’s inquiry may

adversely affect any existing, instituted or pending legal proceedings or any investigation instituted in terms of any law, evidence which is relevant to such proceedings or investigation shall be dealt with by the Commission in such a manner as not to affect adversely such legal proceedings or investigation.”

- 33.3 The argument advanced on behalf of the Reserve Bank was that in terms of the Settlement Agreement, the disputes between Exchange Control and DBJ have been satisfactorily finalised; that the Settlement Agreement addresses the question on reserves neutrality, which was one of the main issues aired during the Commission; that the parties have resolved that dispute; that the Commission’s purpose is to deal with the rapid depreciation and value of the currency and to find any transactions which were either unethical or illegal and which had an effect on the rapid depreciation of the currency; that the share placement transactions and the hedging, funding and related transactions did not affect or lead to or cause the rapid depreciation of the rand. It was pointed out that one of the factors taken into account between the Reserve Bank and DBJ in settling their differences, rather than ventilating them in litigation in the High Court was “... The implications of litigation would have been expensive and time consuming and we do not believe would have given the correct public focus to exchange

control and exchange control regulations. What you would have had in the press would have been a focus on a fight between an international bank and the South African Government on exchange control which would have flown in the face of what the Minister of Finance told us about 15 minutes ago, and that is the gradual relaxation of the process. We believe that it would have given the wrong focus.”<sup>48</sup>

33.4 The submissions on behalf of DBJ are summarised as follows:

- where it is established during the Commission’s enquiry that a particular transaction did not give rise or contribute to the rapid depreciation of the rand in the period under review, it would be outside the scope of the Commission’s Terms of Reference to come to any conclusion as to the legality and ethics of the particular transaction;
- the transactions comprising the asset swaps did not give rise or contribute to the rapid depreciation of the rand;
- the disputes between DBJ and the Reserve Bank have now been resolved: by agreeing to the Settlement Agreement, the Reserve Bank “...has approved all the transactions comprising the asset swaps and has with finality resolved the issues raised in the dispute and rendered an alternative resolution of the dispute or a finding by the Commission in

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<sup>48</sup>

Record 1768-69; 1781-2

respect thereof irrelevant. In these circumstances, any finding by the Commission as to the legality and ethics of the asset swaps and related transactions could only be interpreted as a repudiation of the Reserve Bank's authority.”;

- The Commission should be sensitive to an unfair perception that there is something “dubious” about DBJ's role in the market which could disproportionately affect DBJ's business in South Africa.<sup>49</sup>

### Criminal Conduct

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34.1 Although Exchange Control contends that DBJ breached its administrative law duties, it does not contend that DBJ breached any criminal law duty. Exchange Control submits that, in concluding the Settlement Agreement, it took into account that “DBJ, in failing to adhere to exchange control Regulations, may have:

- not done so wilfully (that is DBJ may have been able to demonstrate an absence of dolus) or negligently (that is DBJ may have been able to show an absence of culpa); and

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<sup>49</sup>

The full submissions are contained in Annexure “H” to Part E.

- being able to demonstrate an absence of negligence (culpa) and possibly been able, on the balance of probabilities, to show that it acted in ignorance of the exact position in connection with Disclosure and Reserves Neutrality in the context of the Exchange Control Regulations, the Orders and Rules, the Rulings and all the Conditions, and that in so doing it was not culpable (in the criminal law sense) in its actions or any assumptions which it may have made.”<sup>50</sup>

34.2 Put prosaically, Exchange Control concedes, in effect, that a criminal prosecution of DBJ would have failed.

#### Breach of Administrative Duties

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35.1 Exchange Control submitted, in regard to DBJ’s alleged breach of the duty of disclosure, that:-

- DBJ should have disclosed in the original Sasol and Nampak share placement applications the hedging, funding and related transactions;
- the so-called currency hedges were in truth and in fact spot transactions by DBJ;

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<sup>50</sup> See pages 13-15 Annexure “F” to Part E

- the forward sales were ostensibly used for a different purpose and were not disclosed at the time of the share placements as forming part of the share placement transactions;
- the non-disclosure on the part of DBJ constituted a breach of the exchange control Regulations and in particular Regulation 10(1)(c) read with Regulation 22, as well as section A of the Rulings.

35.2 Exchange Control submitted, in regard to reserves neutrality:

- there is no exchange control Regulation or Ruling which requires a share placement similar to the Sasol and Nampak share placements to be reserves neutral at the time of the implementation or that a reserves neutral position should be maintained at all times in respect of such transactions;
- nevertheless, it is generally accepted amongst authorised dealers that reserves neutrality is a requirement of share placements;
- the policy of Exchange Control in granting share placement applications is that it will only do so if satisfied that reserves neutrality will be maintained at all times;

- the basis on which Exchange Control granted the share placement applications in question would have ensured reserves neutrality;
- the hedging, funding and related transactions, as implemented, were not reserves neutral (for the reasons set out in §'s 23 and 28 of Part E).<sup>51</sup>

35.3 DBJ's contentions, in regard to disclosure of the hedging, funding and related transactions, were that:

- those transactions were specifically approved by the Reserve Bank or fell within pre-existing general Reserve Bank approvals or were not subject to the exchange control Regulations;
- the disclosure requirement in the Rulings is that "full and precise particulars of the underlying transaction are given in the first instance";
- the "underlying transactions" in respect of the Sasol share placement were the transactions in terms of which Sasol acquired and financed Condea and the underlying transactions in respect of the Nampak share placement were the transactions in terms of which Nampak would

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<sup>51</sup> See Annexure "F" to Part E

capitalise Nampak Holdings (UK) plc and the expansion of the business of its subsidiary, Plysu plc;

- the hedging, funding and related transactions were not “underlying transactions” in terms of the Rulings;
- there was consequently no obligation to give “full and precise particulars” of the hedging, funding and related transactions.

35.4 DBJ’s contentions, in regard to reserves neutrality, were:

- there is no general or specific requirement on the part of the Reserve Bank for share placements to be reserves neutral;
- the Sasol and Nampak share placements and the related transactions were in fact reserves neutral;
- the Sasol and Nampak share placements and the related transactions will be reserves neutral to positive upon their completion.<sup>52</sup>

### Findings

36 The Commission makes the followings findings:-

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<sup>52</sup> For the full submission see Annexure “G” to Part E.

- 36.1 The share placements were not shown to have contributed or given rise to the rapid depreciation of the rand (as Mr Wakeford was led to believe).
- 36.2 The Sasol, Nampak and M-Cell share placements, which were identified in the Wakeford Report, were not in contravention of exchange controls.
- 36.3 The disputes between Exchange Control and DBJ in relation to the hedging, funding and related transactions, relate to the administrative law duties of DBJ. There is no question of potential civil or criminal liability on the part of DBJ.
- 36.4 The currency conversion which was effected in relation to the Sasol hedging, funding and related transactions, can be considered to have contributed to the longer term depreciation of the rand based on the Commission's definition of the impact of a transaction on the currency.
- 36.5 The currency conversions which were effected in relation to the Nampak hedging, funding and related transactions, can be considered to have contributed to the longer term depreciation of the rand based on the Commission's definition of the impact of a transaction on the currency.

37 The Commission is not able to make a positive finding on whether DBJ was in breach of its administrative law duties in regard to the hedging, funding and related transactions. The legal position is not as clear and unequivocal as the two parties contend. It is presumably for that reason, amongst others, that Exchange Control and DBJ settled their differences by concluding the Settlement Agreement.

38 The hedging, funding and related transactions cannot be regarded as unethical in terms of the conduct characterised as unethical in §9 of the Executive Summary.

Clearly, the intention of approving “share placements” is to allow the financing of off-shore investments using local funds in a controlled manner to protect the reserves of the country.

Therefore, based on the Commission’s definition of what constitutes a breach of the “spirit of exchange controls”, the transactions ran contrary to the “spirit of exchange controls” in that there was a lack of up front and complete disclosure with regard to the transactions and the foreign reserves were depleted to the extent that rand was exchanged for foreign currency in the local forex market.

In a sophisticated and dynamic market place, it is accepted that a financial services provider will be pro-actively looking for new products and services to meet the needs of their clients and, at the same time,

maximise revenues. However, through a process like this Commission, all market participants are reminded of their responsibilities towards a sustainable economy and the commitment towards business practices which support the regulatory and other structures implemented by the Government.

39 There are, nevertheless, a few general observations which the Commission wishes to make about an application by an authorised dealer to Exchange Control to make a foreign direct investment.

40 The first is that an authorised dealer is not an uninformed layman. An authorised dealer is assumed to have a working knowledge of the purposes and policies of Exchange Control. An authorised dealer must use its knowledge, experience and common sense in applying exchange controls.

41 The second is that the relationship between the regulator, Exchange Control, and authorised dealer is based on trust. In applications of the kind in question, an authorised dealer must trust Exchange Control to exercise its discretion properly. And, Exchange Control is entitled to trust an authorised dealer to make full disclosure to it of all material

information on which it is required to exercise its discretion to grant an application to make a foreign direct investment.

42 The third is that there should be no doubt in the mind of any authorised dealer what Exchange Control means by South Africa's reserves. For exchange control purposes, the reserves are the total gold and foreign exchange reserves of South Africa. That much is known to anyone who reads the Reserve Bank's Quarterly Bulletin, which one assume authorised dealers do as a matter of course.

43 The fourth is that an authorised dealer who makes application for a foreign direct investment must take into account that:

- one of the purposes of exchange controls is to prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa;
- one of the pre-conditions to the grant of an application to make a foreign direct investment is that the transaction, such as a share placement, when implemented, must not have a negative impact on South Africa's total foreign exchange reserves;
- any related transaction which is concluded consequent to the share placement transaction, such as a hedging or funding transaction, must share one of the characteristics of a share

placement, ie the transaction must be reserves neutral, otherwise – and this is a statement of the obvious – one of the purposes of exchange controls would be frustrated.

44 The fifth is that, by their nature, applications to make foreign direct investments will vary. There is no standard formula for the application or the approval by Exchange Control. If an authorised dealer has any doubt about the requirements of Exchange Control or the extent of its duty to make disclosure, it should consult Exchange Control. It is to the benefit of the authorised dealer, its client and the Reserve Bank that any doubts, ambiguities or concerns are addressed at the time of the application rather than in a protracted review process. (What exacerbated this matter was that the differences between the Reserve Bank and DBJ were aired before the Commission under the intense scrutiny of the media.)

45 The Commission's findings and recommendations in regard to exchange controls look to the future. Exchange Control and authorised dealers should take heed of the lessons learnt from the Exchange Control/DBJ controversy. The Commission hopes that its findings and recommendations will assist the parties in the application of exchange controls during their limited lifespan in their present form.