

Part F: Forex dealing

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F Forex dealing

1 Participants in the forex market

Several foreign banks in New York, London and Europe actively trade in the rand on their emerging market desks in order to service the needs of customers that have an interest in South Africa and to generate income for the bank. International fund managers actively trade in the rand to manage exposures to investments in South Africa and to generate income for the funds. All the major banks are authorised dealers and have large treasury operations to offer their corporate customers access to financial markets, to manage the financial exposures arising from their banking business and to generate income for the banks. Smaller banks which are authorised dealers operate on a similar but smaller basis. Local operations of foreign banks, registered in South Africa, which are authorised dealers, offer treasury and corporate banking services in the local market. Most of the larger corporates runs treasury functions in order to serve the needs of their various operations. The Reserve Bank is an integral part of the financial markets and its trading room activities will mirror those offered in the major trading rooms, domestically and internationally.

## 2 A typical treasury

- 2.1 A typical treasury will be divided into different departments performing different functions: the front office, the back office and risk management. The treasurer is responsible for the entire treasury operation and often reports directly to the chief executive officer.
- 2.2 For the purposes of this Commission, the focus is on the *front office*. The front office is divided into several different desks each focussing on a specific market. A chief dealer who reports to the treasurer will head each desk. The front office desks are the following: forex desk, domestic money market desk, fixed income desk, commodities desk and equities desk. The focus in the Commission is on the *forex desk*. The forex desk transacts all forex products in the rand and in other currencies to service corporate customers and to generate income for the bank. The forex desk is a major source of income to the treasury.
- 2.3 The forex desk is further divided into functional units under the leadership of a chief trader. The forex desk functional units are the spot desk, forward desk, corporate desk and currency options desk. The *spot rand desk* and the *spot rand trader* are usually the focal point of rand activity in the trading room. The rand's spot

trader will make use of several specialised tools to perform his duties: information feeds, technical analysis tools, automated trading terminals, voice broker boxes and sophisticated telephone systems. What is important for the Commission's purposes is the information feeds. Reuters and Bloomburgs are two of the main suppliers of live feeds of financial information to traders. The Reuters and Bloomberg information feeds also provide pricing models for various forex products as part of their service.

2.4 Treasuries are required to be profitable. The set-up costs and running costs of a treasury are very high and require a substantial amount of income just to break even. The activities of a treasury involve high risk and therefore a high return is required. Banking regulation requires that capital be set aside to underpin the risks arising from the treasury. For an active treasury this capital requirement can be substantial and a satisfactory return is required on the capital. All traders are remunerated through incentive structures. These are based on performance exceeding budget and can be very substantial for successful traders.

3 Trading activities are managed by setting various limits and monitoring compliance with those limits very closely. Non-compliance is not tolerated and repeated non-compliance is a dismissible offence. The

types of limits are counter party limits, which represent the maximum exposure to a particular counter party or group of related counter parties; exposure limits, which represent maximum exposure to particular market rates (exchange rates, interest rates, etc); and stock loss limits, which represent a maximum loss that a particular deal or strategy may incur before it must be closed out. These are normally set per trader and per day and per month.

- 4 The factors which affect a trader's views will be the results of market research conducted by the bank at which the trader works or an independent research institute, global and domestic events, political and social conditions, fiscal and monetary policy and rumours. Traders consider all those factors and sources of information and form a view on the very short, and medium term direction of the rand. A trader will then translate this view into a trading strategy designed to generate income and will implement the strategy within the limits available.
- 5 Mr Langley described in evidence how quickly and on what sparse information a trader will deal in the rand. He testified that a spot trader will react to a headline on the Reuters screen first before he actually reads the story. "He is not interested in the story, he is interested in the headline, because he has not got time to read the story." He took the example of the (incorrect) headline "Trevor Manuel resigns" and said that "...

again it would be a negative connotation for South Africa, therefore the trader would go automatically into the spot market and buy dollars [and] when you buy dollars you will automatically sell rand.” He testified that all the banks are subscribed to Reuters. In the life of a trader, it is all a question of getting the information first. “...A trader wants that news, because that is his lifeline ... and he wants it first, because he does not want to be second.” If a trader is second he loses. “From a trader’s point of view you want to be the first one, you want to be the first one to react, you want to be the first one to be out of the blocks there to actually take advantage of that news ...” Mr Langley said that the trader must make a decision and he has to make the decision as the news comes out. He has seconds to make the decision. Five minutes would be too long to make a decision.<sup>1</sup>

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<sup>1</sup> Part F is based on the evidence of Mr M Langley, former Head of Foreign Exchange, Credit Agricole Indosuez, Johannesburg, Expert Bundle 131-143; Record 188-206