

## Part I: Exchange Control

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## I Exchange controls

### [1] Introduction

1 A concise, but comprehensive, review of exchange controls in South Africa is contained in the statement (confirmed in evidence)<sup>1</sup> of Mr Bruce-Brand, general manager, the exchange control department (“Exchange Control”) of the Reserve Bank. A copy is attached as Annexure “A” to Part I. Only matters of material interest to the Commission are dealt with below.

2 South Africa has had exchange controls since 1939. The applicable legislation at present is the Currency and Exchanges Act, 9 of 1933. Section 9(1) of that Act provides that “the [President] may make regulations in regard to any matter directly or indirectly relating to or affecting or having any bearing upon currency, banking or exchanges”. The Exchange Control Regulations (“the Regulations”) were promulgated in 1961 and are amended from time to time. The Minister of Finance issues Orders and Rules under the Regulations.

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<sup>1</sup> Bruce Brand, Bundle SARB (06) 3, Record 534

- 3 Exchange control policy is determined by the Minister of Finance. The application of the policy is refined in consultation with the Governors of the Reserve Bank. The Minister of Finance has delegated to the Governor, a Deputy-Governor, the general manager and various officials of Exchange Control the powers, functions and duties assigned to and imposed on the National Treasury under the Regulations. Exchange Control is responsible for the day-to-day administration of exchange control.
  
- 4 The Minister of Finance has appointed banks to act as authorised dealers in foreign exchange subject to conditions and within limits prescribed by Exchange Control. Authorised dealers are not the agents of Exchange Control but act on behalf of their customers.
  
- 5 Exchange Control has issued Exchange Control Rulings (“the Rulings”) which contain administrative measures as well as the permissions, conditions and limits applicable to transactions in foreign exchange which may be taken by authorised dealers. The Rulings are amended from time to time by way of exchange control circulars (“the Circulars”). In 1990 the Exchange Control Manual (“the Manual”) was issued by the Reserve Bank to assist authorised dealers. The Manual

serves as a general guideline and does not supersede the Regulations, Rulings, Circulars and so on.<sup>2</sup>

6 Applications for foreign exchange received by authorised dealers from their customers are dealt with by them if the applications fall within the parameters outlined in the Rulings without reference to Exchange Control. Applications by customers of the authorised dealers in foreign exchange which fall outside the scope of the Rulings must be referred to Exchange Control for adjudication.

7 The purpose of exchange control is:

- to ensure the repatriation into the South African banking system of all foreign currency acquired by residents of South Africa;
- to prevent the loss of such foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa;
- to effectively control the movement into and out of South Africa of financial and real assets while at the same time not interfering with the efficient operation of the commercial, industrial and financial systems of the country.

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<sup>2</sup> The Regulations, Rulings and Circulars are collectively referred to in this report as “exchange control rules.”

8 After 1994, the South African Government decided on a gradual approach to the elimination of exchange controls rather than a “big-bang” approach. A phased approach allowed Government more time to implement other policy changes in order to achieve the pre-conditions necessary for a successful abolition of exchange control.

9 Government decided that the logical sequencing for the liberalisation of exchange controls would be:-

- (1) the abolition of exchange control on all current account transactions (ie import and export of goods and services);
- (2) the abolition of exchange control on non-residents;
- (3) gradually becoming more lenient in the approval of applications for direct foreign investment by South African corporates;
- (4) allowing institutional investors to acquire foreign assets to diversify their total portfolio investment;
- (5) a progressive relaxation of all other controls on resident individuals; and
- (6) to release emigrants’ blocked funds.

Steps (1) and (2) have been implemented, steps (3), (4) and (5) are in the process of implementation and step (6) has not yet “been looked at”.<sup>3</sup> Dr Stals estimated that about 70% of the exchange controls that existed in 1979 have been removed.<sup>4</sup>

10 The exchange controls which still exist are analysed in the statement of Mr Bruce Brand. For the purposes of the Commission, these are the pertinent remaining exchange controls:-

(1) Corporates

Corporates are allowed, on application, to transfer up to R750 million from South Africa for each new and approved investment in Africa, provided a longer term benefit to South Africa can be demonstrated. In respect of investments elsewhere in the world, corporates are limited to the transfer from South Africa of up to R500 million per new approved investment subject to the same criteria.

Corporates, on application to the Department, are also allowed to utilise their local cash holdings in South Africa to partly finance new investments where the cost thereof exceeds the respective amounts of R750 million and R500 million. Such additional

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<sup>3</sup> Bruce Brand, Record 550

<sup>4</sup> Evidence of Stals, Record 266

foreign currency transfers are restricted to 10% of the cost of the investment in excess of those amounts irrespective of the size of the transaction. The balance of the finance required must still be raised abroad on the basis outlined above.

Corporates wishing to invest in countries outside the CMA<sup>5</sup> may also apply for permission to enter into corporate asset/share swap and share placement transactions to acquire foreign investments.

(2) Institutional Investors

Long term insurers and pension funds may under application acquire foreign portfolio assets of up to 15% of their total assets and registered fund managers up to 15% of their total assets under management, subject to the regulatory framework within which they operate. Unit trusts through unit trust management companies may under application acquire foreign portfolio assets of up to 20% of their total assets under management, subject to the regulatory framework within which they operate. The foreign portfolio assets may be acquired by transferring foreign currency from South Africa abroad. Such transfers are limited to 10% of the previous calendar year's net cash flow.

(3) Individuals

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<sup>5</sup> Common Monetary Area which includes South Africa, Lesotho, Namibia and Swaziland

Individuals may invest up to R750 000 per individual for any purpose outside the CMA provided the party is over eighteen years old and a registered taxpayer in good standing.

- 11 Cross-border (onshore/off-shore) foreign exchange transactions executed by authorised dealers on behalf of their customers are reported to the Reserve Bank on a daily basis. These are called “reportable transactions”. On-shore/on-shore and off-shore/off-shore transactions are not reportable. On-shore/on-shore transactions comprise inter-bank transactions. Off-shore/off-shore transactions take place outside of South Africa. The Reserve Bank is therefore not able to report on them as it has no source of information or jurisdiction over non-residents.

[2] Recommendations by authorised dealers

- 12 The authorised dealers were asked the following question in the Questionnaire:<sup>6</sup> “7.9 What recommendations do you have regarding the administration of exchange control?” The evidence of the material authorised dealers in response to that question was as follows:-

12.1 Absa

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<sup>6</sup> The Questionnaire prepared by the Deloitte & Touche team. See Part K.

The exchange controls are open to conflicting interpretations and therefore have at times resulted in an “uneven playing field” and in the extreme, a marketing tool for some of the more aggressive authorised dealers. As an example, an authorised dealer will often accuse another authorised dealer of allowing a particular transaction that should, in its opinion, have been refused. Issues relating to the interpretation of payment which could be categorised as payment of “fees in respect of services rendered” (a new category) often result in differences of opinion between authorised dealers.<sup>7</sup>

## 12.2 Nedcor

In Nedcor’s opinion, the problems with complying with exchange controls are the following:-

- Divergent interpretations of authorised dealers in respect of certain aspects of the Rulings. The competitive nature of the market places an authorised dealer at the risk of losing client business in the event of strict interpretations of certain Rulings.

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<sup>7</sup> Evidence of Mr RL Rabuzzi, General Manager, Operations and Technology, International Banking SA, Absa Corporate and Merchant Bank, [Absa Bundle 42](#)

- Lack of transparency of exchange control related information between the Reserve Bank and authorised dealers pertaining to specific approvals granted to multi-banked clients.
- The current requirement for the presentation of paper-based documentation to support cross-border payment transactions is not necessarily effective and is open to abuse. The documentation is easily replicated.
- Initiatives to improve processing efficiencies through automation in the relevant back office environments are restricted by the current high cost, manual, paper-based exchange control requirements.
- The difficulty of enforcing compliance with South African exchange controls against foreign banks.
- The accurate matching of multiple debit transactions against credit transactions against CFC accounts can be problematic. This is further complicated where clients maintain multiple CFC accounts at more than one authorised dealer.

Nedcor's recommendations are the following:-

- Compliance with Exchange Control Regulations should be based on the electronic monitoring of trade and payment transactions wherever possible. This would require the

alignment/integration of databases of the relevant parties involved in trade transactions, i.e. SARS, Reserve Bank and authorised dealers.

- The level of compliance could be improved by placing more emphasis on the accountability of customers who hold CFC accounts. A process similar to the current “letter of undertaking” for import and export clients could be used for these account holders.
- Restrictions could be placed on the movement of funds between CFC accounts held by persons at different authorised dealers.
- A representative forum should be established to review existing and planned future exchange controls, agreeing on procedures which will ensure high levels of compliance and ultimately improve the effectiveness of such controls.<sup>8</sup>

### 12.3 NIB

In most cases, the provisions contained in the Circulars are incorporated as clear and precise amendments in the Rulings themselves. There are, however, some instances where the provisions of the Circulars are not incorporated in the Rulings.

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<sup>8</sup> Evidence of Mr MS Parker, Executive General Manager, Treasury, Nedcor, Nedcor Bundle 27-28

This gives rise to confusion. For example, sections B(17) and C(10) of the Rulings, which govern forward cover transactions, have not been updated to reflect the provisions of the circular dealing with the post 14 October 2001 amendments applicable to non-residents' local dealings in these transactions. Any fundamental changes incorporated in the circulars must be reflected as amendments to the Rulings.<sup>9</sup>

#### 12.4 Investec

The two main problems are:

- section G, in addition to other rules, is ambiguous and leads to different interpretations as to what is permissible; and
- the difficulty in enforcing compliance by non-resident banks of Circular D342 dated 15 October 2001.<sup>10</sup>

Recommendations made by Investec were:

- re-introducing Circular D226, thereby alleviating the administrative burden currently placed on the authorised dealers by Circular D342;
- making all corporates “document exact” but ensure real time monitoring of balance of payments;

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<sup>9</sup> Evidence of Mr P Lane, Executive Director of NIB with responsibility for the Treasury Division, NIB Bundle 26

<sup>10</sup> Evidence of Ms PF Trollip, Global Head of Treasury Compliance, Investec, Investec Bundle 24

- the removal of remaining exchange controls in an orderly and controlled fashion in an attempt to improve off-shore investor sentiment, thereby improving economic growth.<sup>11</sup>

#### 12.5 FirstRand Bank

The problems that FirstRand Bank have with the administration of exchange controls are:-

- There is insufficient certainty with regard to the interpretation of Exchange Control with specific emphasis about what non-resident banks and non-residents are allowed to transact.
- There is insufficient consultation by Exchange Control with authorised dealers before Rulings are made. Invariably, there is consultation, debate and amendments between Exchange Control and authorised dealers after Rulings have been issued, which results in uncertainty and ultimately in negative sentiment towards the country, putting pressure on the rand.
- The bank has added functionality to a number of systems where practical and economically viable but exchange control still requires significant manual intervention. Exchange control administration limits the bank's ability

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<sup>11</sup> Evidence of De Villiers, Investec Bundle 38-39

to achieve straight through processing since it requires human intervention and decision making and adds to the cost of doing foreign exchange business.

- Non-residents are allowed to trade with any authorised dealer in South Africa and may have accounts at more than one authorised dealer. It is thus impossible to ensure that non-residents comply with exchange control. Which means that non-residents are required to self-regulate.

The recommendations made by FirstRand Bank are:-

- Exchange control is an artificial mechanism that creates an inefficient allocation of resources and invariably has unintended side-effects which require further regulation. This process detracts from confidence in South Africa and ultimately in the rand. In FirstRand's view, it is a question of process, procedure and timing but one view is that "... one would tend towards and orderly [abolition] of exchange control."
- Failing the abolition of the exchange controls, FirstRand recommends that the Reserve Bank ensures that the

Rulings and Circulars are clear and well-defined and that they apply equally to all players within the market.<sup>12</sup>

#### 12.6 JP Morgan

The events of the fourth quarter of 2001 demonstrate the real difficulties of enforcing and managing exchange control, particularly in relation to off-shore participants in the rand market. JP Morgan endorses the stated position of the National Treasury and Exchange Control in favour of the expeditious but phased relaxation of exchange controls. In the interim, JP Morgan favours the continuation of consultation and the interaction between Exchange Control and authorised dealers in order to effectively enforce and administer existing exchange control requirements.<sup>13</sup>

#### 12.7 Deutsche Bank (“DBJ”)

It is important that South Africa strives for a fully convertible currency. Convertibility risk is a major concern among all investors and is a significant reason why foreign capital inflows into South Africa have been modest for several decades.<sup>14</sup>

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<sup>12</sup> Evidence of Mr JJH Bester, Head of Risk and Audit Services, FirstRand Bank, FirstRand Bundle 19-21; Record 1377-8

<sup>13</sup> Evidence of Mr JJ Coulter, JP Morgan Bundle 18

<sup>14</sup> Evidence of Morrison, Deutsche Bank Bundle 13

12.8 Standard Corporate and Merchant Bank (“SCMB”)

The following specific areas of concern have been encountered by SCMB and demonstrate some of the difficulties in administering the exchange control regulations and rulings:

- the requirements that clients present documentation and evidence of a firm and ascertainable commitment is not effective considering that clients are entitled to hedge or unhedge foreign exchange commitments during the life of the transactions with different authorised dealers;
- the administration of CFC accounts in order to control the 180-day rule is cumbersome;
- the issue of compliance certificates by foreign banks has been introduced but SCMB has found a large number of counter-parties not willing to co-operate.<sup>15</sup>

[3] Recommendations of the Reserve Bank regarding the administration of exchange control

13 During the hearing, the Commission asked the Reserve Bank for its recommendations. The Reserve Bank responded by giving evidence that the effectiveness of the current administrative system of enforcing exchange control is interlinked with and dependent upon the fullest

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<sup>15</sup> Evidence of Potgieter, Standard Bank Bundle 44-45

cooperation from all the authorised dealers and the clients for whom they act in matters of exchange control. The relationship between the authorised dealers, their clients and Exchange Control has as its underlying rationale a duty of utmost good faith, transparency and trust. Without this the system cannot function effectively. In light of everything that was said by the Reserve Bank to the Commission, Mr Bruce-Brand was of the opinion that exchange controls are effective provided that all role players fulfil their obligations in both the spirit and the letter of the existing rules and regulations. By and large the experience of Exchange Control is that it is the norm. The effectiveness of the primary objective, i.e. the protection of South Africa's foreign reserves, is borne out by growth in the reserves from about two weeks of import cover in 1994 to the prevailing level of about twenty-four weeks of import cover. This objective has been achieved against the background of extensive exchange control liberalisation and a significant reduction in Government's foreign exchange liabilities.<sup>16</sup>

[4] Compliance by the authorised dealers

- 14 The authorised dealers were requested in the Questionnaire to furnish the following information:-

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<sup>16</sup> Bruce-Brand Bundle SARB (8) 236-7

“4.6

4.6.1 What procedures does your organisation use to monitor Excon compliance?

4.6.2 In your response, please specifically address, inter alia:

4.6.2.1 at what stage of conducting a foreign exchange transaction compliance with exchange control is verified and how this is managed and controlled;

4.6.2.2 procedures in place to ensure that exporters comply with the 180 day rule to repatriate foreign exchange proceeds;

4.6.2.3 procedures employed to monitor CFC accounts and to monitor overdrawn vostro accounts;

4.6.2.4 the extent to which your Excon procedures provide you with assurance that trades with corporates and non-resident banks are backed by firm and ascertainable commitments; ...”

15 Detailed evidence was given by the large authorised dealers (who account for about 95% of all forex dealing in South Africa) in response to those questions. What follows is a summary of their evidence.

Absa

15.1 Foreign exchange transactions are concluded in two ways: clients may either request an authorised branch or one of Absa's five international banking centres ("the centres") to book foreign deals on their behalf, or, if they are appropriately mandated by Absa International Banking Department in this regard, clients may elect to book deals directly with Absa's treasury dealing room ("the dealing room"). Where a client has approached a branch or centre to book a deal on its behalf, the branch or centre will, without exception, ensure, before proceeding, that the underlying transaction is permissible in terms of exchange control rules. If a current client has concluded a forex deal directly with the dealing room, the details of the deal are communicated to the relevant branch or centre, and it is the branch or centre's responsibility, in all instances, to ensure that the transaction is permissible in terms of Excon rules. The internal audit department monitors adherence to certain exchange control limits by means of Computer Assistant Auditing Techniques (CAATS). Excesses are reflected on a report and are investigated. Contraventions and any corrective actions are reported to the Reserve Bank. Monitoring of limits is for all intents and purposes done manually.

- 15.2 Whenever a Form F.178 (the form that is completed in relation to the requirement to repatriate foreign exchange export proceeds within 180 days) is attested to by an Absa branch or centre, the details are recorded and diarised for follow up of receipt of the export proceeds. If the notification is not timeously received, the client or the receiving authorised dealer is followed up by means of a letter. If a satisfactory response remains outstanding after three requests, the matter is reported to the Reserve Bank, as required by the exchange control rules.
- 15.3 All CFC accounts are managed and maintained within Absa's middle office and five centres, in that way enhancing the effectiveness of the monitoring and control process. A system-generated report, listing particulars of all CFC account credits which are within seven days of expiry of the required one hundred and eighty day period, is drawn up by each centre. It is that centre's responsibility to inform clients of the impending expiry of the stipulated one hundred and eighty day period and to ensure that the funds are converted accordingly within the period as required by exchange control rules. If the funds are not converted within the period, Absa will follow up with a client in order to expedite the conversion. If the client's co-operation is not

forthcoming, Absa reports the matter to the Reserve Bank as required by the exchange control rules.

- 15.4 In all instances where a corporate client books a deal directly with the dealing room, the underlying transaction is not finalised until it has been vetted and found to be permissible in terms of exchange control rules or has been authorised in terms of a specific approval granted by Exchange Control. All branches and centres are subject to regular internal and external (Reserve Bank) audits and inspections, one of the main focus areas of which is to ensure that all transactions concluded by the branches and centres comply fully with the requirements and conditions prescribed in the exchange control rules.<sup>17</sup>

#### Nedcor

- 15.5 A centralised exchange control department is in place. Each quarter, all business units are required to complete and submit a compliance report to the group compliance unit. Internal audit conducts reviews of all business units on a regular basis, preferably annually. The reviews include the evaluation of compliance of exchange control rules. Dedicated risk managers are located in the major processing centres handling customer-initiated transactions. One of their functions involves the

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<sup>17</sup> Evidence of Rebuzzi, Absa Bundle 36-41

evaluation of the effectiveness of Reserve Bank related controls and compliance on an ongoing basis.

- 15.6 Cross-border pay-away of funds is verified prior to processing of the pay-away. In respect of other transactions, a risk/compliance management process has been implemented, which includes procedures such as independent sampling and regular internal audit reviews. The bank is also subject to periodic inspections by the Reserve Bank.
- 15.7 The F178 form is sent from a branch to a dedicated F178 section within a department of Global Business Operations (“GBO”) within the bank. The F178 section will capture the relevant data on its system. The system gives the exporters seven days grace after the expected payment date to provide the bank with evidence of export proceeds received. Should no such evidence be lodged with the bank, the F178 system generates a schedule/report on the exporters and amounts not received as per F178. The system will automatically generate a letter to remind the exporter that it must forward evidence of export proceeds received to the bank. Regular follow-up procedures are executed in case the exporter does not respond to the letter. Should no proceeds be received within 180 days from shipment date, a

report of the exporters and their outstanding proceeds is forwarded to the bank's exchange control department, which in turn, will report the matter to Exchange Control.

15.8 CFC accounts are marketed, sold and opened by forex and trade marketing officials in the bank. GBO will process the transaction. GBO will also confirm that Exchange Control approval has been granted to purchase or sell foreign exchange and execute the CFC transaction. Incorrect transactions are investigated by GBO and rectified. The reports which are generated in terms of the system generate data which is used for the 180 day exchange control process described earlier.

15.9 Exchange Control requires that "when transferring funds between CFC accounts, the authorised dealer effecting the transfer must make use of a free format MT100 and quote the date on which the funds were originally credited to a CFC account..." The bank is trying to comply with this requirement. The difficulty arises from the fact that when funds are transferred between CFC accounts at different authorised dealers, the total amount transferred may be made up of smaller amounts that were originally credited on various dates over an extended period not exceeding 180 days.<sup>18</sup>

NIB

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<sup>18</sup> Evidence of Parker, Nedcor Bundle 11-12; 36-39

- 15.10 Each NIB entity involved in transactions affected by the Reserve Bank is guided by separate and dedicated internal operational and administrative procedures. Reserve Bank compliance reports are generated by affected business units at intervals stipulated by the Reserve Bank and then submitted to the Reserve Bank if required. From this data and information a summarised report is presented to the NIB Operational Risk Committee on a monthly basis by the NIB Group Compliance officer.
- 15.11 Spot transactions: if required in terms of exchange control rules, the prescribed documentation is called for from the client to substantiate that the underlying transaction exists and that it is permitted in terms of exchange control rules. The underlying documents are then stamped “exchange provided”. The back office will call for a copy of the Reserve Bank approval from the NIB exchange control department in cases which require prior Reserve Bank approval. The Reserve Bank may, in certain circumstances, exempt importers and exporters from providing the prescribed substantiating documents. The transaction is then confirmed with the client and settlement takes place at the end of two working days calculated from the time when the client

concluded the trade with the dealing room. At this point, the transaction is also reported to the Reserve Bank.

15.12 Forward transactions: procedures followed are basically the same as for spot transactions, save that the prescribed underlying documentation, where required by exchange control rules, only need to be viewed and stamped “forward cover granted” by NIB’s back office within fourteen days from the date of concluding the transaction.

15.13 NIB does not offer CFC accounts.

15.14 Where NIB is requested to attest to a form F178 for clients on short-term exports, the transaction is diarised for follow-up with a client at the end of the 180 day period.<sup>19</sup>

#### FirstRand Bank

15.15 The bank strictly adheres to a Deal Conclusion Forum process in respect of structured transactions. The Deal Conclusion Forum consists of senior management representing each of the functional areas and includes independent exchange control sign-off by the bank’s in-house exchange control specialist. Every non-standard deal is presented to the Deal Conclusion Forum by the transactor or transacting team. An in-depth analysis and term sign-off are integral to the sign-off process.

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<sup>19</sup> Evidence of Lane, NIB Bundle 15-17

### Direct dealing customer

15.16 A number of the bank's clients, typically large corporates, have direct access to its foreign exchange trading desk. On the deal being entered, an electronic deal device is sent to the bank's foreign exchange operation centre responsible for that client. The foreign exchange operations centres are responsible for all the administrative functions related to the transaction. The centres send out a confirmation of the deal and request the client to bring in the relevant documentation in order for the bank to verify that the transaction is in compliance with exchange control rules. No settlement takes place until the process is completed. The documentation is checked and stamped "exchange provided" and handed back to the customer, whereafter it is settled. Compliance is therefore verified prior to settlement.

### Branch dealing

15.17 The bank has seventeen foreign exchange operations centres in the main metropolitan areas. Before any deal is struck the operations centre ensures that the deal complies with exchange control rules, checks the customer's credit limit and stamps the documentation "exchange provided" (if required) for the transaction. Only then is the deal booked into the branch dealing

system. If documentation cannot be provided at the time that the client was to take out forward cover, the bank will book the deal on condition that the client provides the bank with documentation within a maximum period of fourteen days, but in any event before settlement. Settlement does not take place unless the bank has verified compliance with exchange control rules.

e-Forex

- 15.18 This is the bank's electronic dealing and payment system that is available for installation at the client's offices. The procedures are similar to those of the direct dealing clients in that compliance with exchange control rules is verified at an operation centre and no settlements take place before the process is completed.
- 15.19 The bank has various procedures in place to ensure compliance with the 180-day rule. The operation centres have a specific exchange control department that is responsible for the administration and follow-up on all the attested F178s. A diary system is kept to ensure that funds are received within the prescribed period. When no funds are forthcoming, the client is contacted and it has to provide satisfactory reasons or rectify the situation. Where export proceeds are not received within the 180-

day period, the bank is obliged to report non-receipt to the Reserve Bank.<sup>20</sup>

Investec

15.20 Investec has various ways in which it monitors exchange control compliance. It has two important risk management forums, a New Business Committee, known as the Deal Forum, which is responsible for approving new deal structures and the Credit Committee, which is responsible for approving credit limits. Either of those forums will identify transactions that require exchange control approval and the committees' approval is subject to exchange control approval.

15.21 The bank employs exchange control officers who advise and monitor areas within the bank which have exchange control responsibilities. These officers provide the liaison between the bank and Exchange Control. In addition, the relevant business divisions have dedicated personnel responsible for exchange control compliance within their areas on a day-to-day basis.

15.22 The bank's internal audit division performs regular audits in addition to those undertaken by Exchange Control

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<sup>20</sup> Evidence of Mr AS Ribbens, Head of the First National Bank Foreign Exchange Product House, a division of FirstRand Bank, [FirstRand Bundle 42-47](#)

15.23 Within the treasury division of the bank, foreign exchange trading falls into two main categories, “vanilla” transactions (i.e. straight forward transactions) and structured transactions. With regard to vanilla transactions, the responsibility for exchange control compliance lies within two areas: treasury compliance for non-resident banks and the corporate treasury administration area for corporate transactions. All structured transactions are discussed with the treasury compliance team and are either approved as complying with section G of the Rulings or specific exchange control approval is sought via the exchange control officers.<sup>21</sup>

#### BoE

15.24 The bank has procedures in place to monitor exchange control compliance. These procedures are applied to non-bank transactions and focus on three areas:-

- Payments to non-residents in rand and foreign currency

The branches of the bank are obliged to ensure that clients provide them with documentary evidence of the commitment to the non-resident and/or a respective Reserve Bank authority. Where the outward payments are in respect of allowances, such as travel allowances,

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<sup>21</sup> Evidence of Ms Trollip, Investec Bundle 18-20

the allowance limits and supporting documents are required before making payment;

- Transfer of assets to non-residents

The bank has procedures in place to ensure that transactions are concluded at fair market value and at arms-length in that the non-resident pays for assets being acquired before a non-resident endorsement is placed on any document of title;

- Control over goods exported

The branches of the bank are obliged to ensure that the stipulated follow-up procedures are adhered to, to ensure that either goods or the sale proceeds thereof are returned to South Africa.

15.25 During the conduct of a foreign exchange transaction, the branches of the bank are not permitted to authorise payments to non-residents without viewing the required documentation and verifying the authenticity of the documents. The treasury prints and reviews CFC account statements daily and the balances are monitored to ensure compliance by exporters with the 180-day rule to repatriate foreign exchange proceeds. The bank's internal

control and compliance procedures are well documented and monitored on a continual basis.<sup>22</sup>

### Citibank

15.26 Citibank has an “excon department”. In *manual* applications to buy or sell foreign currency, all the relevant documents are forwarded to the excon department for approval. If the documents are in compliance with the exchange control rules, the department approves the transaction and the documents are stamped accordingly. If the documents are not in order, the excon department issues an instruction to that effect. Until the defects are remedied, the transaction is not processed. Once the excon department has approved the transaction and the customer has confirmed it, the excon department reviews the application electronically from the process centre. In *electronic* applications, a similar process is followed, save that the excon department records its approval by electronic notes. The original documents are received manually and suitably endorsed by the excon department. The excon department plays a similar role in respect of *branch* transactions, which may also be manual or electronic in form.

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<sup>22</sup>

Evidence of Mr G Little, Head of Treasury Operations at BoE, BoE Bundle 6-8

15.27 In regard to 180 day transactions, on the due date the customer account is checked by the trade department for the credit amount reflected on the F.178 form. In the absence of a corresponding credit, the customer is contacted by the trade department and requested to supply the bank with proof of incoming funds. If the customer does not respond within a month, a second query is automatically raised. In most instances the customer is contacted by telephone before the queries are raised. If the customer advises the bank that funds will not be received in respect of the export, it is requested to provide its advices in this regard in writing and to furnish reasons. The matter is then reported to Exchange Control. After contacting the customer directly, Exchange Control advises Citibank of any action it might have taken. Should the customer not revert to Citibank within the given time, it again refers the matter to Exchange Control.

15.28 CFC accounts are monitored on a daily basis. A report is generated indicating all accounts that will reflect a movement on them the previous business day. In the case of a credit reflected on a customer's account, a copy will be made of the deposit. The date, 180 days from the date reflected on the account, is diarised for follow-up purposes. On the due date, a print-out of the

customer's account is obtained by the excon department for a period of 180 days prior to the due date, to determine whether the value of the debits on the account are equal to the value of the credits on the account. If any exceptions are identified, these are reported by the excon department to the Exchange Control.<sup>23</sup>

### JP Morgan

15.29 JP Morgan does not provide CFC or vostro settlement accounts. In respect of transactions with other authorised dealers, JP Morgan has very limited exchange control compliance requirements. In respect of transactions with other local institutions, such as pension funds and fund managers, JP Morgan determines whether there is a forex element to the transaction. If so, the bank either obtains evidence of separate exchange control approval from the institution or requests the institution to provide approval from its authorised dealer, which in most cases is a party other than JP Morgan. In respect of transactions with local corporates, the bank does not conduct any retail activities such as issuing letters of credit or travellers cheques and does not offer CFC or vostro accounts.<sup>24</sup>

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<sup>23</sup> Evidence of Mr A Ayeyemi, Senior Country Operations Officer, Citibank, Citibank Bundle 2-5, 9-17

<sup>24</sup> Evidence of Coulter, JP Morgan Bundle 13-15

Deutsche Bank (“DBJ”)

15.30 DBJ does not participate in retail banking. It does not have any vostro accounts and does not maintain CFC accounts.

15.31 The monitoring of exchange control compliance commences at the outset of the DBJ/client relationship when DBJ adopts a new client. The client adoption procedure encompasses the “know your client” rule. When DBJ sets up a foreign exchange trading account with a specific client, it establishes the precise nature of a client’s business activities. The traders verify the exchange control requirements with a counter-party at the time of entering into a forward exchange contract in order to ensure that the trades are backed by firm and ascertainable commitments.<sup>25</sup>

15.32 Deutsche Bank is not aware of any transactions that contravened exchange controls during 2001.

SCMB

15.33 The monitoring of exchange control compliance in the bank is a formidable task, which is undertaken at 57 retail branches countrywide and at 14 International Business Centres (“IBC’s”). Bank employees ensure exchange control compliance by viewing, stamping and endorsing documents as required by the exchange control rules. On-going staff training is conducted to ensure that

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<sup>25</sup> Evidence of Morrison, Deutsche Bank Bundle 10

staff are fully conversant with the requirements of exchange control. In addition to internal training, external training is provided to customers of the bank. All areas of the bank dealing with foreign exchange have an updated copy of the Rulings on hand. To ensure that the interpretation of the Rulings remains up to date, a representative from SCMB attends the bi-monthly Reserve Bank Rulings Committee meetings. The Reserve Bank conducts regular exchange control inspections at the various IBC's. Monthly *internal* inspections are performed to ensure continuing compliance with exchange control rules.

15.34 Where errors are discovered during the inspection process, a form 10951 application is submitted to the Reserve Bank in terms of which the Reserve Bank is notified of any contraventions of its Regulations and Rulings. During 2001, twelve such applications were submitted for a combined total of R5.3 million.

15.35 The bank requires its clients to sign a declaration in appropriate cases that the contract is in respect of either a firm and ascertained underlying commitment to or accrual from a non-resident and that there is no existing foreign exchange cover in respect of the transaction.

15.36 The bank fulfils its role in ensuring compliance with the 180 day rule by keeping a copy of the F178 form and capturing it on its system. The form is filed by the bank under its due date and it is later matched with the foreign currency receipt. On the maturity date any F178 form which has not been matched with the payment is reported by the system. In those cases clients are contacted to provide proof of receipt of funds or reasons for non-receipt. Any irregularities are reported to the Reserve Bank.

15.37 The average days weighted by amount on attested F178 forms for 2001 ranged from 60 days, eg in October, to 120 days, eg in November, 2001.

15.38 The bank has detailed processes in place for monitoring CFC accounts and vostro accounts.<sup>26</sup>

[5] The Reserve Bank's response to the comments of the authorised dealers

16 On 7 May 2002 Mr Bruce-Brand dealt with the various criticisms and suggestions of the authorised dealers as follows:-

16.1 The authorised dealers report to Exchange Control when they do not receive the compliance letters from non-resident banks. The Reserve Bank is reviewing the current position with regard to

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<sup>26</sup> Evidence of Potgieter, Standard Bank Bundle 26-39

such non-compliance, but it is in the interim allowing transactions to proceed in order not to interfere unduly with the smooth operation of the forex market in South Africa. Compliance letters continue to be called for and non-receipt must still be reported to Exchange Control.

- 16.2 It is a fact that there is a cost to administering exchange controls for the authorised dealers. In a post exchange control environment, however, there are still likely to be costs in order to ensure compliance with prudential requirements, money laundering and the collection of balance of payments data.
- 16.3 There were relatively few difficulties reported with the approximately 5.6 million foreign exchange transactions which were reported to Exchange Control during 2001. Difficulties, in the main, are limited to share placements. The number of transactions successfully implemented in 2001 bears testimony to the fact that exchange controls operate efficiently and effectively within the policy parameters set by the Minister of Finance.
- 16.4 A minor inconsistency or an unclear point in exchange control rules does not render the administration of exchange controls in their totality ineffective.

- 16.5 Authorised dealers have the opportunity to air their views on any issue relating to exchange controls at the Liaison Committee, which meets quarterly under the chairmanship of Mr Bruce-Brand. Unfortunately, authorised dealers have been sending more junior delegates of late.
- 16.6 Every effort is made by the Reserve Bank to implement exchange controls in order to facilitate the commercial transactions of the South African economy. A degree of flexibility is applied in the implementation of exchange control rules. If, in some instances, flexibility leads to uncertainty, it is a price worth paying.
- 16.7 Any application to Exchange Control has a certain motive and intent. If that intent is not disclosed or exposed willingly, then the applicant is not being transparent in its ultimate aim or objective. An approval by Exchange Control, which has been achieved under those circumstances, may eventually result in consequences not acceptable to Exchange Control. Exchange Control cannot be expected to anticipate undisclosed transactions having a bearing on the application on which it must make a decision.<sup>27</sup>

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<sup>27</sup> Evidence of Bruce-Brand, Bundle SARB (9) 1-7

[6] The KPMG investigation into exchange control administration

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17.1 An investigation team of four members, all employed by KPMG, was appointed by the Commission to investigate the effectiveness of the current administrative system of ensuring adherence to exchange controls in guarding against hot transactions and to advise the Commission on measures to improve such system. (“the KPMG team”). The members of the team included exchange control and financial experts. The team prepared a report which was handed in in evidence by the team leader, Mrs Beck. In view of the report’s importance for Exchange Control, the report is attached to Part I marked “B” (“the KPMG report”).<sup>28</sup> What follows is a brief analysis.

17.2 The KPMG team conducted its investigation in three stages:

- (1) Discussions were held with Exchange Control, covering the following topics:
  - the structure and operation of Exchange Control and its relationship with authorised dealers;

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<sup>28</sup> Evidence of Mrs A Beck, Report on Exchange Control Administration; Record 1614 - 1658

- the processing of exchange control applications by Exchange Control, including the systems used and the internal processes;
  - the mechanics of import and export undertaking; and
  - Exchange Control's areas of concern;
- (2) An evaluation of Exchange Control was done by assessing its systems and procedures for the approval of capital transactions exceeding R100 million submitted to Exchange Control from 1 January to 31 December 2001.
- (3) Views were obtained in regard to Exchange Control administration of the authorised dealers, the external auditors who are parties to import/export undertakings and large corporates active in the foreign exchange market.

17.3 The KPMG team came to the conclusion that the *strengths* of the Exchange Control administration were the following:-

- (1) Exchange Control has effective controls for ensuring the validity of applications and for ensuring that it has received all the applications submitted by authorised dealers.

- (2) A response to an application requires dual control before it is given to the authorised dealer to enhance control over and consistency of approvals.
- (3) The electronic feeding of cross-border foreign exchange data from authorised dealers should help to provide timeous and complete information for balance of payment statistics.
- (4) Import/export undertakings have removed a substantial amount of the paperwork that used to be the responsibility of authorised dealers. As import/export undertakings are only given to clients that have a good system of control and are deemed low risk, this improves the overall efficiency of Exchange Control administration. Inspections by Exchange Control and the corporates' external auditors help to ensure compliance with exchange control.
- (5) Authorised dealers have implemented processes to ensure compliance with exchange control rules and are responsible for about 99.5% of forex transactions. The transactions are audited by the authorised dealers' internal auditors and by Exchange Control inspections to ensure compliance with exchange control.

17.4 The *drawbacks* of exchange control administration, according to the KPMG team, and the team's recommendations were as follows:-

(1) Export proceeds and CFC accounts

An exporter can illegally exceed the 180 days retention limit in a CFC account by opening CFC accounts with more than one authorised dealer and by then moving the foreign currency between the different CFC accounts. Some authorised dealers receive funds and MT100<sup>29</sup> forms without dates and assume that those are new funds as it is too onerous to follow up manually.

If full use were made of the permitted time periods, an exporter could retain its proceeds in foreign currency for 210 days: the permissible off-shore retention of 30 days and the retention in a CFC account for 180 days. Exporters may grant credit terms of 180 days, which authorised dealers are permitted to extend for 180 days, which could result in the conversion of the export proceeds to 570 days

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To ensure an audit trail of the source and timing of the receipt of export proceeds, authorised dealers are prohibited from accepting any foreign currency from other authorised dealers without a form MT100. A form MT100 is an electronic message that shows the amount of foreign currency and the date it was credited to a CFC account.

from date of export. This is only likely to occur between related parties.

The repatriation of export proceeds can never be completely controlled. Exchange Control has no direct control over export proceeds until they are deposited in a CFC account or sold to an authorised dealer. Exchange Control will not know when an exporter's off-shore client pays for the goods. Neither will Exchange Control know whether the exporter has complied with the 30 day time limit within which such export proceeds have to be credited to a CFC account or sold at spot. It is not practical for Exchange Control or the authorised dealers to monitor this and reliance has to be placed on exporters.

Exchange Control uses the F178 form to control the repatriation of proceeds of *goods* exported. There is no equivalent for the export of *services* and therefore Exchange Control relies on the corporate to repatriate fees earned off-shore.

(2) Double counting

In terms of exchange control regulation 3(1)(f), non-residents and domestic entities that are more than 75% or

more foreign owned or controlled (called affected persons) are restricted in the amount of local financial assistance that they may use. Authorised dealers may grant or authorise local financial assistance to non-residents or affected persons, provided that such financial assistance will not cause the borrower to exceed 100% of the unencumbered rand value of funds that he has introduced from abroad or realised profits accumulated to invest locally.

The regulation can be contravened when a non-resident or an affected person borrows security or funds from a local bank and presents the proceeds as a capital base to borrow against from another bank. This is called double counting. With those funds the non-resident could take a larger position in the rand.

Non-residents are permitted to trade with any authorised dealer and may have accounts with more than one authorised dealer. It is therefore impossible for the lender to ensure compliance with exchange control.

(3) Shorting the rand

An authorised dealer is required to ascertain whether a non-resident has a legitimate exposure resulting from an accrual, investment or asset denominated in rand, before it concludes a forward exchange contract (“FEC”) with such non-resident. If a non-resident buys an FEC to hedge an underlying rand asset, for example, shares and then later sells the shares and buys foreign currency at spot to remit the proceeds of the sale off-shore, he could retain the FEC without the authorised dealer knowing this. This could enable the non-resident to short the rand and take a position in the rand. This is illegal.

This form of shorting the rand cannot be controlled or identified. The extent is unknown. It could negatively affect South Africa’s foreign reserves and contribute to pressure on the rand.

(4) Staff competence

A proper level of training and competence of staff dealing with exchange control and exchange control applications is difficult to maintain. This applies to all parties responsible for implementing exchange control, i.e.

Exchange Control, authorised dealers, external auditors and corporates.

(5) Transfer pricing

Profit can be transferred overseas through over-invoicing to a South African importer or under-invoicing by a South African exporter. Foreign companies may over-invoice their South African subsidiaries to gain preferential tax benefits overseas or, in the expectation that the rand will depreciate, to remove profit from South Africa throughout the year rather than only on the declaration of the dividend. The extent of the problem cannot be assessed. It could negatively affect South Africa's foreign reserves and contribute to pressure on the rand.

(6) Import and Export undertakings

There are eight identifiable weaknesses in the audit by external auditors of compliance by corporates with exchange control rules. The audit process is one developed by the South African Institute of Chartered Accountants ("SAICA") in conjunction with Exchange Control.

(7) Submission of applications

Exchange Control requires authorised dealers to ensure that the applicant complies with all the conditions stated in the approval. This can be difficult when the currency is bought or sold through an authorised dealer other than the one with which the application was made or where the application was submitted directly to Exchange Control and not through an authorised dealer. Furthermore, it is possible to transfer more than the amount approved when foreign currency is bought from more than one authorised dealer and none from the authorised dealer who submitted the application.

Exchange Control cannot identify from the cross-border foreign exchange system whether the approved transaction has been concluded as the insertion of the Exchange Control approval number on a transaction is not mandatory. Mandatory insertion of the approval number would enable Exchange Control to monitor and ensure that approved limits are not exceeded.

Limits which are exceeded could negatively effect South Africa's foreign reserves and contribute to the depreciation of the rand.

(8) Compliance with approval conditions

In terms of all approvals given by Exchange Control to corporates to invest off-shore, it is a requirement for the resident investor to submit annual financial statements of the off-shore entity to Exchange Control and to remit profits to South Africa annually. Authorised dealers do not always effectively monitor, and the corporates do not always comply, with those requirements.

This could negatively affect South Africa's foreign reserves.

(9) Data in applications

It is not feasible for Exchange Control to verify all the data submitted in an application. Exchange Control therefore relies on the integrity of the applicant (both the corporate and the authorised dealer) to submit complete and accurate information.

(10) Inconsistency of approvals

It is perceived by some of the corporates that:-

- exchange control, especially with regard to off-shore investment, is not applied consistently across all legal entities and transactions;
- Exchange Control assumes that listed and large companies have better controls and corporate governance than privately owned smaller companies;
- approval can be obtained if Exchange Control deems there to be a longer term benefit to South Africa and the concepts “longer term benefit” is open to interpretation since it is subject to the discretion of Exchange Control.

(11) Accuracy of Reserve Bank cross-border foreign exchange data

The team identified several transactions with large input errors. The team also identified a transaction where a corporate or authorised dealer incorrectly recorded a deposit of USD60 million as a freight payment instead of a money market transaction.

(12) Authorised dealer systems

Most authorised dealers use sophisticated treasury systems developed overseas, which do not cater for exchange control. Consequently, additional systems have to be developed by the authorised dealers for exchange control at significant cost. Alternatively, manual systems have to be used. The systems are costly to develop and maintain.

(13) Communication by Exchange Control

- (a) Although there is a rulings committee that acts as a forum for the authorised dealers, several authorised dealers commented that there is insufficient consultation by Exchange Control with them before rulings are made. The team's recommendation is that Exchange Control should be more consultative in deciding policy and strategies to monitor policies.
- (b) Where an application is turned down by Exchange Control, it does not usually give reasons for its refusal to grant the application. The

recommendation is that reasons should be given where an application is rejected.

- (c) Some of the Rulings are outdated. The team recommends that, to avoid confusion, the Rulings which are out of date, should be completely re-written with the assistance of authorised dealers.
- (d) The Manual is the only access the public has to the implementation of exchange control policy. While the Manual is apparently up to date at the moment, it has not always been so in the past.
- (e) Changes to the Rulings are not adequately communicated to corporates, especially those who are involved in import and export undertakings. The recommendation is that all changes to exchange control rules should be communicated to both the corporates and the media.

(14) Small transactions

Exchange control is onerous and focuses on detail rather than on substance. For the authorised dealers, exchange control is expensive and time consuming. In the current exchange control approval system, the value of a

transaction is irrelevant, often resulting in costs out of proportion to the value of the transaction being incurred. It is recommended that routine and smaller transactions should be excluded from scrutiny with materiality levels being put in place. This would reduce the unproductive scrutiny of immaterial transactions.

(15) Foreign direct investment (“FDI”)

Exchange control is a deterrent to FDI and should be reviewed. When foreign investors decide to invest in South Africa, it is often the first time that they have experienced exchange control. They usually regard exchange control as a bureaucracy that will hinder the efficient management of their investments.

Although it is claimed that all exchange controls on foreign investments have been removed, this is not correct. The KPMG report lists 10 examples (§134.1 – 134.10 of the KPMG report, annexure “B” to Part I).

(16) Emigration

With the depreciation of the rand the tendency is for someone leaving South Africa to use the investment allowance (R750 000 per person or R1.5 m for a family

unit) rather than the emigration allowance (of R400 000).

Consequently there is no notification to the authorities of the emigration.

## 17.5 Abolition of exchange control

17.5.1 There are (at least) four good reasons to abolish exchange control:

- off-shore investors see exchange control as a major deterrent for foreign direct investment;
- in terms of their mandate, certain off-shore fund managers are not allowed to invest in countries having exchange control;
- domestic corporates are often charged higher fees and rates to raise funds off-shore than would have been the case without exchange control;
- off-shore listings by South African companies are often a consequence of the limitations on off-shore investments.

17.5.2 There are three major sources of funds that could be exported if exchange control were abolished:

- institutional investors;
- blocked funds relating to emigrants;

- domestic corporates who wish to invest abroad or obtain off-shore listings.

17.5.3 The negative consequences of a gradual abolition of exchange control could be off-set by inter alia the following:

- by means of a gradual increase in the percentage of funds that institutional investors may invest off-shore, Exchange Control could control the outflow of currency from South Africa;
- a portion of the blocked funds could be released over a period of four to five years to minimise the strain on domestic foreign reserves;
- in the case of South African companies listing off-shore, the off-shore transfer of the shares could be treated as a disposal of those shares on which capital gains tax or a similar tax could be applied.

[7] Liberalisation of exchange controls

18 The Minister of Finance testified that, as has been broadly recognised internationally, a gradual approach to capital account liberalisation is

advisable and should occur late in the process of economic reform. The Government has chosen a policy of gradual liberalisation of exchange controls based on a set of key policy and structural requirements:-

- (1) It is imperative that the appropriate macro-economic fundamentals be put in place. These include credible and sustainable fiscal and monetary policies; pro-growth trade and investment policies and a Government spending programme that promotes redistribution and provides a safety net for the poor against the potential social costs of globalisation.
- (2) In an environment of global integration with large and rapid shifts in capital flows, it is essential for a sound and well-regulated financial system to be in place.
- (3) The Government has chosen to follow a flexible exchange rate to act as a shock absorber against global developments.<sup>30</sup>

19 The Director-General, National Treasury, gave evidence on the extent to which key policy and structural requirements have been met.

(1) Macro-economic stability

A pre-condition for capital account liberalisation is credible and supportive fiscal and monetary policy. This reduces the scope for domestically generated instability and capital flight. The

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<sup>30</sup> Evidence of Manuel, National Treasury Bundle (1) 83-84

objective of macro-economic stability has now been achieved: the fiscal deficit has come down from approximately 5% in 1994/1995 to 1.9% in 2000/01 and is expected to be 1.4% for 2001/2 and the Government has implemented an inflation target of 3-6%, compared with consumer price inflation of about 9% in 1994/1995.

(2) Tax policy reform

The relaxation of exchange controls has been accompanied by key income tax reforms to protect the tax base and minimise tax biases that could encourage the export of capital. This has primarily taken the form of a shift from a source-based to a residence-based system of income tax.

(3) Social safety nets

An important component of the sequencing of exchange control reform is to have a social safety net in place. This mitigates the possible negative impact on the poor of potential financial instability which could result from an ill-considered pace of capital account liberalisation. South Africa has one of the most extensive systems of social safety nets amongst emerging market economies.

(4) Domestic financial market reform

Complete liberalisation and large capital flows increase the danger of bank failures if not properly managed. In these circumstances competent bank management, realistic valuation of bank assets, increased public disclosure and prudential reporting become important characteristics of a sound banking system. The objective of bank supervision and regulation under these circumstances should be to avoid any systemic risks to the banking system.

(5) Capital account liberalisation has been accompanied by significant reforms to a robust financial market infrastructure. Despite repeated episodes of exchange rate pressure and sharp depreciation, South Africa has been protected by a regulatory system that is well established and sophisticated in comparison with other emerging markets.

(6) A further reform signalled in 2001 in the form of a shift to prudential regulation, will see exchange controls on life insurers and pension funds replaced by prudential limits on foreign investments.

(7) The relaxation of exchange controls has to be managed to be in line with the country's balance of payments. Capital inflows and

trade proceeds provide a source of foreign exchange within which the capital account should be managed if a major impact on the exchange rate is to be avoided.

- 20 The evidence of the experts and authorised dealers was generally supportive of the Government's policy of gradual liberalisation of exchange controls. What was nevertheless emphasised was the negative sentiment towards exchange controls and the disadvantages of exchange controls. *Mr Luüs* said that the exchange controls which are still in place potentially deter foreign investment because foreigners believe that the gradual or sudden removal of such controls would lead to a gradual or sudden further depreciation of the rand and because of a fear that comprehensive exchange controls may again be implemented at any time.<sup>31</sup> It was recommended by *Investec* that remaining exchange controls should be removed in an orderly and controlled fashion in an attempt to improve off-shore investors' sentiment, thereby improving economic growth.<sup>32</sup> The evidence for *FirstRand Bank* was that exchange control is an artificial mechanism that creates an inefficient allocation of resources and invariably has unintended side effects which require further regulation. This process detracts from confidence in South Africa

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<sup>31</sup> See Evidence of Luüs in [Part D §6.3](#)

<sup>32</sup> Evidence of De Villiers, [Part I §12.4](#)

and ultimately in the rand.<sup>33</sup> The events of the fourth quarter of 2001 demonstrated to *JP Morgan* the real difficulties of enforcing and managing exchange control, particularly in relation to off-shore participants in the rand market. JP Morgan endorses the policy in favour of the expeditious but phased relaxation of exchange controls.<sup>34</sup> For *Deutsche Bank Johannesburg* it is important that South Africa strives for a fully convertible currency. Convertibility risk is major concern among all investors and is a significant reason why foreign capital inflows into South Africa have been modest for several decades.<sup>35</sup> The *KPMG team* was of the view that there were at least four good reasons to abolish exchange control:

- off-shore investors see exchange control as a major deterrent for foreign direct investment;
- in terms of their mandate, certain off-shore fund managers are not allowed to invest in countries having exchange controls;
- domestic corporates are often charged higher fees and rates to raise funds off-shore than would have been the case without exchange control;
- off-shore listings by South African companies are often a consequence of the limitations on off-shore investments.

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<sup>33</sup> Evidence of Bester, Part I §12.5

<sup>34</sup> Evidence of Coulter, Part I §12.6

<sup>35</sup> Evidence of Morrison, Part I §12.7

- 21 In reply to the question posed by Goldman Sachs to 30 of its clients: “what is the biggest change that would be positive for the rand?”, 21% said: “more open markets”, ie remove exchange controls.<sup>36</sup>
- 22 In Dr O Neill’s opinion, the events of late 2001 suggest that with foreign exchange controls, one either has no controls or one has complete controls. But, if one has partial controls, it is confusing and very hard for people to understand except those very close to monitoring them and implementing them. It is also often taken as a sign of lack of confidence in other targets and in particular if there is an inflation targeting regime in place. It was not obvious to Dr O’Neill what purpose foreign exchange controls serve. In his view, if the removal of exchange controls was done in the context of specifically targeting more foreign direct investments and enhancing a greater broadening of the understanding of the inflation targeting regime, he believes that the abolition of exchange controls will lead to a significant inflow and strengthening of the rand.<sup>37</sup>

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<sup>36</sup> See §36 Part D  
<sup>37</sup> See §37(6) Part D

23 In his closing remarks to the Commission on 24 May 2002, the Minister of Finance<sup>38</sup> re-affirmed the Government's commitment to a gradual process of exchange control liberalisation that takes into account critical sequencing considerations. Timing and sequencing are critical. It has been broadly recognised internationally that a gradual approach to liberalisation is advisable and should occur late in the process of economic reform. The IMF has stated that it considers the present pace of exchange control liberalisation in South Africa to be appropriate. Prudent liberalisation must consider factors such as the sequencing of economic reform and the strengthening of the balance of payments. As such, it is not possible to set a time table for the gradual relaxation of exchange controls, rather such a policy will be monitored and reviewed continuously. There is another benefit to a gradual approach to liberalisation and that is that gradualism may produce internal and external criticism about the slow pace of reform, but it has also avoided policy reversals in the face of currency crises. A gradual approach to exchange control liberalisation has enabled the Government to deliver a policy message which is consistent and certain.

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See [Record 1754-1761](#)