

2002-05-07: Statement by Alexander Macgregor Bruce-Brand on behalf of the Exchange Control Department of the SA Reserve Bank

1. There are several outstanding issues that you have asked the South African Reserve Bank to address. The purpose of this statement is therefore to address these outstanding issues. At the conclusion of my statement, Mr Lambertus Van Zyl, Advisor to the Governor, will deal with the South African Reserve Bank's perspective on the consequence of the decision to apply existing exchange controls on South African Authorised Dealers in respect of transactions with non-residents. I now turn to deal with the issues raised at the Commission since the South African Reserve Bank last gave evidence.

2. Share Placements:

During calendar year 2001 the Exchange Control Department to which I shall refer to as "Exchange Control" approved 12 share placements/corporate swaps to the value of approximately R22.9 billion. Of this seven approvals were, for a variety of reasons, not proceeded with. Transactions totalling approximately R4 billion were implemented. A detailed breakdown of these transactions have been made available to the Commission.

3. Compliance Letters:

3.1 Authorised Dealers have testified that they have not always received the so-called letters of compliance to satisfy the requirements of Exchange Control Circular D.342 of 2001-10-16. The non-receipt has been reported to Exchange Control.

3.2 As part of its monitoring process the Bank is reviewing the current position with regard to such non-compliance, but is in the interim allowing transactions to proceed. The reason for this is not to unduly interfere with the smooth operation of the foreign exchange market in South Africa. Compliance letters continue to be called for and non-receipt thereof must still be reported to Exchange Control.

4. Reserves Neutrality:

4.1 What is essentially a very simple concept has been somewhat confused by aspects of evidence presented to this Commission over the last few weeks.

4.2 Firstly, for exchange control purposes the reserves refer to the total gold and foreign exchange reserves of South Africa as a country. I submit that in an exchange control environment reserves neutrality cannot reasonably refer to any other reserves, for example only the reserves of the Central Bank. These reserves are negatively affected if a foreign currency outflow takes place and positively affected if a foreign currency inflow takes place.

4.3 Should Exchange Control authorise a foreign outward investment and approve the transfer abroad of the R500 million (or R750 million in the case of investments in Africa) in foreign currency, that outflow negatively impacts on the reserves of the country.

4.4 Exchange control policy, as laid down by the Minister of Finance, permits the transfer abroad of the R500 million (or R750 million in the case of investments in Africa) in foreign currency, and a further amount of 10% of the balance between R500 million, or R750 million, as the case may be, and the total cost of the foreign investment. This is, therefore, the loss or decrease in the foreign reserves which South Africa is prepared to accept. In other words, South Africa is prepared to forego R500 million (or R750 million in the case of investments in Africa) of its reserves to allow a corporate to make a foreign acquisition. (For record purposes this amount was progressively increased from R20 million in 1996 to R500 million in 2000.)

4.5 In those cases where the cost of the foreign investment exceeds R500 million and a corporate chooses to raise the excess funding required by means of, inter alia, a share placement, this exercise cannot be allowed to take place in any manner which may further negatively impact on the reserves of the country.

4.6 As a consequence of what is stated above, when agreeing to a share placement Exchange Control requires that, save for the R500 million (or R750 million investment in the case of Africa), reserves neutrality is, at all times, maintained. Furthermore, any approval will be granted subject to such flowback as may occur (flowback has a negative impact on the reserves) being rectified. Flowback is rectified by instructing the relevant corporate to refinance abroad the negative outflow with a positive inflow. (The corporate and the Authorised Dealer are well aware of this condition since it is so stipulated at the time the approval is granted).

4.7 What is set out above concerning flowback being rectified, serves to ensure that the loss of foreign exchange from the reserves of the country is limited to the R500 million (or R750 million in the case of investments in Africa) plus the 10% referred to in 4.4 above and, therefore, restores reserves neutrality as far as any excess loss is concerned.

4.8 It is, therefore, self evident that no other transaction should be engineered, under any guise, to exceed the permissible outflows prescribed by the Minister of Finance.

4.9 In contemplating the transactions in issue, the question arises of whether bonds were purchased by Deutsche Bank London and whether they paid for them or not. The fact remains that Exchange Control would not take into account the foreign exchange which may or may not have come into South Africa's reserves for the purposes of adjudicating upon the relevant Share Placement transactions. Acquisitions of South African assets by non-residents built up in this manner prior to an application to Exchange Control for a Share Placement would definitely not be considered by Exchange Control as a motivating factor. If this alleged addition to the reserves is a factor, why was it not disclosed in the original application to Exchange Control?

5. Costs and Applicability of Exchange Control:

5.1 Comment has been passed on the cost of administering exchange controls. Mr Chairman, yes, this is a fact and in a post exchange control environment 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.

5.2 There has been testimony to the effect that an estimated 70% of exchange controls that existed at one stage have been abolished and that the balance “are not very effective and not very important anymore” and may as well be removed. The removal of exchange control is a policy issue which falls within the domain of the Minister of Finance. Insofar as the implementation of existing exchange controls is concerned I wish to highlight the following.

5.3 Whilst I agree that a large portion of the administrative burden (such as making an application to Exchange Control for any current payment in excess of a given Rand amount limit) has been done away with, capital controls on South African residents still remain - it is only the quantitative limits that have been generously increased over the last few years. It is evident that each time limits are increased, further outflows of capital from South Africa take place which indicates the effectiveness of the current controls.

5.4 Having regard to all the evidence which has been led before this Commission on the enforceability or otherwise of exchange controls, I believe that I owe the Commission, on behalf of Authorised Dealers (who co-administer exchange controls) and Exchange Control, some sense of perspective.

5.5 As you will recall at page 21 of my previous testimony, which is contained in SARB Volume 6, approximately 5.6 million foreign exchange transactions were reported during 2001 to Exchange Control. This Commission has heard evidence of difficulties which have occurred in a very small number of these transactions. The difficulties that have been brought to the attention of this Commission are, in the main, limited to one form of transaction, namely, share placements. I submit that it is unfair to judge the effectiveness of the entire exchange control system on these few transactions, when it is clear that the vast majority of foreign exchange transactions are implemented without difficulty. 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.

5.6 I do not wish to harp on the apparent inconsistencies in exchange controls, which may have been conveyed by some of the Authorised Dealers. At the end of the day

these are minor if regard is had to the reasons for continuing with exchange controls. To suggest that a minor inconsistency or unclear point, renders the administration of exchange controls (in their totality) ineffective is akin to suggesting that one person's tax evasion renders the entire tax system ineffective.

5.7 I am the chairperson of what is referred to as the Liaison Committee, where Authorised Dealers have the opportunity to air their views on any issue relating to exchange controls. The Liaison Committee meets on a quarterly basis and has recently held its 51st meeting. The meetings are of a formal nature and each Authorised Dealer is represented at the meetings. Minutes of the meetings are kept and recommendations are acted on either in the form of new Exchange Control Circulars or by means of clarification in the minutes themselves. Unfortunately, the Authorised Dealers have, of late, not always availed themselves of this opportunity in that more junior delegates attend these meetings. The Authorised Dealers are therefore afforded an opportunity to deal with perceived inequities or inconsistencies not only during the course of these liaison meetings but also by means of direct communication with Exchange Control.

5.8 It is inevitable that exchange controls restrict Authorised Dealers from implementing transactions which they believe to be to their client's advantage. Although Exchange Control is sensitive to the legitimate needs of corporate South Africa, those needs cannot be implemented in a manner that exceeds the prescribed limits laid down by the Minister of Finance, and which is not in the interests of South Africa as a whole.

5.9 Every effort is made by the South African Reserve Bank in its implementation of exchange controls to facilitate the commercial transactions of the South African economy. Thus a degree of flexibility is applied in the implementation of the Exchange Control Regulations, and if, in some instances, such flexibility leads to uncertainty, it is, I believe, a price worth paying.

5.10 With reference to my evidence at pages 18 to 20 of SARB Volume 6, I pointed out that the 180 day/CFC administration and compliance procedures were changed by Exchange Control at the request of the Authorised Dealer community to assist them in their task. Exchange control policy is, as previously recorded, the domain of the Minister of Finance. Authorised Dealers have always been invited to suggest further exchange control liberalisations.

6. In concluding, may I state that any application to Exchange Control has a certain motive and intent and if that intent is not disclosed or exposed willingly, then the applicant is not being transparent in its ultimate aim or objective. An approval from Exchange Control, which has been achieved under these circumstances can therefore eventually result in consequences not acceptable to Exchange Control. Finally I fail to see how any regulatory authority can be expected to anticipate undisclosed transactions having a bearing on the application on which it must make a decision.

Thank you very much